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The Federal Reserve Banks

Re: The Federal Reserve Banks Payment System Improvement – Public Consultation Paper

To Whom It May Concern:

Deutsche Bank Trust Company Americas (DBTCA) welcomes the opportunity to collaborate with the Federal Reserve Banks (FRB) and with the industry in the exploration of improvements to the United States (U.S.) payment system. In addition to this letter, DBTCA has participated in industry responses from both the Clearing House and from the American Bankers Association. In considering our reply, DBTCA consulted a number of its businesses including, Global Transaction Banking, Private Wealth Management, and Treasury to ensure that a broad representation of views was included in this discussion.

We appreciate the ongoing support that the FRB provides to help drive industry-led initiatives to improve the payment system. We agree there are actions that the FRB can take to improve efficiency and change, which are detailed below.

General Principles for Successful Outcome

To ensure this activity yields beneficial results, we recommend the following guidelines are maintained throughout the process:

- Change should be driven by clearly articulated, demonstrable and pervasive market problems.
- Multiple problems might not necessarily be solvable by a single solution, even though this may sometimes be possible. We recommend a product portfolio approach be adopted.
- End-users of a solution should be willing to pay for the value of having a problem solved. The economic interests of all participants in a solution should be met to ensure sustainability.
- Future solutions also should consider all types of risk related to financial transfers and their successful mitigation as a component of value creation.

End-User Needs

Recognizing that the needs of end-users should drive change, it is important to consider the following:

- Differentiation should be made between different types of end users: retail clients have different needs and expectations from business clients. Indeed, a finer segmentation is likely needed within each segment and based on different use cases. It is crucial to understand what problem will be addressed, what the real-life experience and use cases are.

- In line with the point above, a fundamental gap not fully addressed in the FRB paper is the distinction between the need for real-time information, real-time availability and real-time clearing and settlement. The three characteristics are related but not identical and could be resolved differently. Better clarity on the user need allows for better definition of the service levels and the product portfolio needed to respond to the need.
- The FRB does not have direct relationships with end users and might not be in the best position to quickly respond to end-user demands. The FRB might improve its sphere of influence over needed changes by expanding relationships more deeply into non-bank providers and technology vendors; at a minimum, by more uniformly applying regulation to these entities, the FRB and other regulators will exert greater control over the end-user experience and provide a platform to create changes.
- Achievement of a ubiquitous payment system might be best accomplished by creating a network of connected and interoperable systems, rather than updating a single, monolithic service. As detailed below, combining functionality from existing systems leaves room for innovation, enables faster time-to-market, and more granular service definition, thus driving greater choice of service levels to address different, possibly contradictory use cases. The underlying principle to uphold is interoperability, which the FRB is in an ideal position to help define.

Retail user gaps:

- One major gap not identified in the paper is access to the payment system. Setting aside unbanked US consumers, those with bank accounts access them using a variety of channels (e.g. mobile, cards, online, etc.). With so many options and the rapid pace of creation of new ones, ubiquity might not be achievable. Closer relationships between the FRB, the industry, and the providers of these access channels will foster improved development.

Business user gaps:

- As noted in the Paper, a large portion of check volume is derived from consumer-to-business bill-pay transactions. To reduce the collection cost of these funds by businesses and to drive adoption of electronic processes, it is important to address a major concern of businesses: that retail clients will adopt the payment method. Addressing the aforementioned retail user gap will, in turn, alleviate this concern by many small or medium businesses (SMB's) and larger businesses as well as encourage investment by them in providing these options to their clients.
- Two major concerns we have heard from our business clients related to point-of-sale (POS) transactions are cost and information security. For POS transactions, most of the gaps highlighted in the FRB paper are addressed by existing methods, i.e. cash, online payment options or payment card.
    a. However, business users face high processing costs, such as interchange fees, for which there are few mitigating opportunities.
    b. Additionally, when offering payment card options to their clients, business users might lose control of the transaction information related to that event, which might erode retail end-user confidence and dilutes the efficiency of the payment method for the business user. For example, non-bank payment processors have the opportunity to consolidate and sell information about the types of purchases of a given retail end-user to a party not part of any aggregated transaction.

Adoption by either a business or a retail end user will be driven by factors such as convenience, switching costs, and ubiquity. By controlling cost, offering an "open" network, and providing confidence in the security of the process, the FRB will address these factors and encourage widespread adoption.

Comment on Desired Outcomes Four and Five

Desired Outcome 4: Better choice in making convenient, cost-effective and timely cross-border payments

- Cross-border payments are a good example of the conflicting effects of the desired attributes of ubiquity, lower cost and high speed as outlined in the FRB comments. The cross-border payment ecosystem is designed to enable ubiquity as it is an interconnected web of multiple networks of correspondents and clearing systems. Indeed banks can distribute payments virtually anywhere. However, the cost and perceived slow speed of cross-border transfers are driven by this same factor, the decentralized infrastructure. The key to future improvement therefore should include enhanced interoperability.
- Stronger anti-money laundering (AML), Know Your Customer (KYC) and sanctions requirements have exacerbated the conflict outlined above as banks have made and continue to make massive investments in AML/KYC, sanctions enforcement and other regulatory obligations, which require payment validation prior to execution. Before significant progress can be made in delivering a consistent experience across domestic and international funds transfers, a major reevaluation of the international regulatory framework is required. This review should align not only AML, KYC and sanctions programs, but also should formally and legally permit parties along the payment lifecycle to rely on the due diligence performed by prior parties.
- In this context, we note that the cross-border payment mechanisms of some non-bank payment providers leverage connections to domestic automated clearing house (ACH) systems in various markets to offer more economical services to end users. In many cases, these structures are arranged in a way that removes transaction parties from the technical party fields of a payment order, as the domestic systems aren't designed to handle cross-border flows, either completely dropping this information or moving it into an inappropriate details field. In many cases, this transformation prevents the downstream financial institution from recognizing the cross-border nature of the payment and therefore precludes appropriate AML, sanctions review, tax regulations and currency controls, all of which are major drivers of cost in cross-border transfers. These payment methods are examples of poorly designed interoperability where technical accommodations are made to the detriment of risk controls in the overall system. Any future interoperability feature should include an end-to-end view of risk and regulation.
- Finally, one element which should be carefully considered when evaluating options to address gaps in cross-border payments, in particular services that rely on a small number of highly connected and dependent networks, is vulnerability to systemic risk. The risk of contagion of an endemic crisis, liquidity risk, credit and settlement risk all should be assessed and weighed against the objectives of any change. We suggest that the FRB align views on such risks with the efforts of the FSB and IOSCO on Financial Market Infrastructure recovery and resolution. Also, here again, a clear definition of the problem that will be addressed including a clear use case is fundamental to finding the optimal balance between cost, speed and risk.

Desired Outcome 5: Promote the security of the payment system; maintain public confidence

- In order to improve the security of the system, preserve confidence, and enhance the effectiveness of the network, we believe that uniform regulation should be extended to all payment service providers, both bank and non-bank, allowing consistent service delivery to end users.
- Additionally, applying a framework for authentication and fraud detection, such as the one exists within the card network today, will provide a familiar level of security to either a business or a retail end user, encouraging adoption and use within any new system. Authentication processes that combine a physical device (i.e. something you have), with secure shared information (i.e. a personal identification number (PIN), something you know), inspire confidence and comfort. The highly sophisticated fraud detection capability of the card networks, relying on historical end-user behavior and other patterns, coupled with rapid feedback to the participants, serves both the provider and end user well. However, it should be noted that the size of an individual payment has a great impact on the effectiveness of these methods; larger payments typical in

business-to-business transactions are not well-suited to the statistical foundation of these detection processes.

Implementation and Timeframe

We believe that any improvement should not necessitate the creation of a new system; improvement should leverage existing systems and networks or a combination of existing systems. Focus on an existing network will accomplish several underlying outcomes:

- Support for broad functionality: a multiple-systems approach might more easily cater to different needs while retaining flexibility in the new system will maintain room for innovation; where improvement should be made over the existing model will be in interconnectivity and interoperability.
- Reduction in the cost for development: using an existing framework will allow participants to use software and systems already in place.
- Suppression of the barriers to entry for new participants: the existing system is supported by a robust network of software providers, consultants and other experts who can assist new entrants in participating; new systems will require the development of a similar support network.
- Acceleration in the time for development: building upon an established foundation will require less effort to expand than when creating from the ground up.
- Encouragement for adoption as the system or combination of systems are "known" and more readily accepted: the existing system, network or combination inspires confidence and comfort in end-users; processes are known, legislation established, clear conflict resolution and other mechanisms are already defined.

Given this recommendation, the proposed timeframe of approximately 10 years might be too long. While slower development allows for more complete services to be delivered and reduces the occurrence of error, new payment services and technologies have been created and offered to the US community in months. In this environment, end users will adopt new services well before the completion of a ten-year plan, making adoption of a new service more cumbersome. Additionally, this slower development cycle will be outpaced by changes in technology so that the original target will require modification during the process to remain relevant, further delaying delivery. Thus, in an effort to remain current, we recommend a shorter-term development plan which incorporates a phased approach to achieving the ultimate target.

Summary

Initiatives to generate industry collaboration, both within the US and with the global community, will have an enormous impact on the efficiency of payment systems. We encourage the FRB to continue with this project and anticipate the opportunity to work together in the future.

Regards,

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