

Submitted by the Iowa Bankers Association
Payment System Task Force
December 3, 2013

The Iowa Bankers Association (IBA) Payments Task force is pleased to respond to the Federal Reserve Payment System Improvement – Public Consultation Paper. The IBA is an association of 347 banks ranging from the smallest community banks to several of the largest U.S. banks. In 2011 during its annual strategic planning process, the Iowa Bankers Association board of directors pinpointed payments as an issue of significant importance for the future of the banking industry. Bankers in the room understood that the payment system was and is evolving very rapidly and failure to adapt could be fatal for the industry and harmful for consumers.

The task force believes that it is uniquely suited to provide meaningful input on this complex topic. Its membership is on the front line of the payment system and they are also key payment leaders that have and continue to serve on national level boards and committees including the American Bankers Association, Independent Community Bankers of America, National Automated Clearing House Association, the Chicago Federal Reserve Bank regional board, and Shazam; an Iowa based and bank owned regional processing association that serves in excess of 1,300 central U. S. banks and credit unions for ACH and debit card processing. The Task Force appreciates the opportunity to comment.

New electronic payment networks continue to proliferate including networks for person-to-person transfers, online merchants, business trade payments and others. But many of these networks do not have a broad base of membership or widespread adoption making it inconvenient or impossible for in-network end users to make or receive payments to/from out-of network end users. By contrast, legacy payment systems can be nearly ubiquitous allowing end users to send payments to almost any receiver without requiring the receiver to enroll in the system or retrieve the payment. Legacy payment systems provide a solid foundation for future payment services; but some of these systems (e.g. check and ACH) rely on paper-based and/or batch processes which are not fast or efficient enough to satisfy modern expectations. The challenge is to provide a payment system for the future that maintains the valuable attributes of the current legacy payment system; convenience, safety, universal reach, low cost – and combine it with new technology that enables faster processing, enhanced convenience, and the safeguarding of customer information.

A key question is who will take the lead in solving these payment issues and coordinating the desired results? The IBA Payments Task Force believes it is imperative that the Central Bank of the United States play a lead role. Likewise, consumers have rightly trusted their debit and credit information with banks for a hundred plus years. They naturally want to go to their own bank for these types of services and the regulatory structure is already in place to ensure safety and soundness of the legacy payment system. For these reasons we believe it is essential that the banking industry play a key role in providing meaningful input on this monumental shift in how consumer and business payments are made. To that end, the IBA Payments Task Force has spent many hours, days and months focusing on:

1. Interoperability and universal access to payments services – including standardization across mobile payment technologies and across provider solutions.

2. Consumer demand for mobile and on-line payment options.
3. Privacy, fraud and compliance risks of mobile and on-line banking.
4. The need for collaboration with partners who both understand the mobile space and are able to keep pace with changes, and
5. A possible pilot project to create a universal directory for P2P and P2B transactions.

Members of the IBA Payment Task Force can attest that The Payment System Improvement – Public Consultation Paper released by the Federal Reserve on Sept. 10, 2013 and the five desired outcomes truly do reflect a collective and collaborative approach involving input from a variety of industry stakeholders including our task force of Iowa bankers. We also agree with the five desired outcomes outlined in the paper although we prefer a shorter timeline to address the gaps and opportunities identified. The following answers to the questions posed by the Consultation Paper are reflective of the combined opinions the IBA task force members:

Question 1: Are you in general agreement with the payment system gaps and opportunities identified in the consultation paper? Please explain if desired. What other gaps or opportunities not mentioned in the paper could be addressed to make improvements to the U.S. payment system?

The IBA Payment Task Force agrees with the gaps and opportunities set out in the Consultation Paper and find them to be consistent with the work product of our task force.

Question 2: Are you in general agreement with the desired outcomes for payment system improvements over the next 10 years? Please explain if desired. What other outcomes should be pursued?

The IBA task force is in general agreement with the five desired outcomes although we believe the 10 year timeline is too long in a rapidly evolving payment system. The task force also believes that non-bank service providers must have consistent regulation, equal accountability and security, and be able to promise that payments will settle in the exact same manner that FDIC insured banks are required to do today. We further believe that the Federal Reserve should play a strong role in defining security protocols for all parties – bank and non-bank – and make sure a system is in place that ensures monitoring and enforcement of these protocols for all parties. Absent this basic tenant, public confidence in the security of the payment system will at some point be challenged amid a rapidly evolving technology and threat environment.

Question 3: In what ways should the Federal Reserve Banks help improve the payment system as an operator, leader, and/or catalyst?

The task force believes the free market is in the process of creating a number of what we consider to be robust sub-directories and this is happening and will continue to happen faster than expected. At some point, we believe it is important for a trusted entity to serve as a central

directory or a directory of those sub-directories which are owned or operated by private entities. In other words - the task force feels the goal of a fast, efficient, and open payment system with good funds and near real time payment with notice and reconciliation is best achieved through a collaborative effort involving the Federal Reserve serving in the capacity to manage and/or monitor a central or directory of directories that facilitates the connection of senders and receivers. The Federal Reserve Bank is in a unique position to be able to balance the needs of all parties including and most importantly consumers. The task force further believes the Fed should not weigh in, mandate or limit pricing options. In other words, they should not discourage or mandate the same pricing models for various payment options like good funds, near real time or real time. Doing so will limit innovation and investment.

Question 4: In discussions with industry participants, some have stated that implementing a system for near-real-time payments with the features described in the second desired outcome (ubiquitous participation; sender doesn't need to know the bank account number of the recipient; confirmation of good funds is made at the initiation of the payment; sender and receiver receive timely notification that the payment has been made; funds debited from the payer and made available in near real time to the payee will require coordinated action by a public authority or industry group. Others have stated that current payment services are evolving toward this outcome and no special action by a public authority or industry group is required.

i. Which of these perspectives is more accurate, and why?

The current U.S. payment system is fragmented, slow, and confusing to consumers. It is a closed loop system requiring multiple layers of registration and it is not evolving on its own, or at least not developing on its own as fast as needed, toward the desired outcome. The IBA task force supports and believes it is essential that the Federal Reserve engages in and proceeds with a strategic plan that will enable end to end payments that do not require the receiver to provide confidential information to the sender.

ii. What other perspective(s) should be considered?

The task force further supports efforts to develop new and secure identification/verification models that would prevent the need for the Federal Reserve to store personal identification and related account information of either the sender or receiver. These technologies exist today and new advances are on the horizon. The IBA task force believes that once these technologies are implemented, it will buffer the Federal Reserve in its role as a central directory or a directory of directories from the risk of a data breach of critical and confidential consumer information.

Payment services continue to evolve and the need for clarity of error resolution to protect consumers is rapidly increasing. A "rules-of-the-road" standard to reduce conflict of existing payment rules (UCC, Reg E, ACH) would be beneficial. By way of example, the Check21 standards facilitated the conversion from paper to electronic delivery even though some players had their own exchanges.

Question 5: The second desired outcome articulates features that are desirable for a near-real-time payments system. They include:

- a. Ubiquitous participation**
- b. Sender doesn't need to know the bank account number of the recipient**
- c. Confirmation of good funds is made at the initiation of the payment**
- d. Sender and receiver receive timely notification that the payment has been made**
- e. Funds debited from the payer and made available in near-real time to the payee**

i. Do you agree that these are important features of a U.S. near-real-time system? Please explain if desired.

The IBA task force agrees that these are the most important features of a U.S. near real time system.

ii. What other characteristics or features are important for a U.S. near-real-time system

ii. The system should provide privacy and security protocols and protections for both the sender and receiver. All players - bank and non-bank and direct and indirect - should be held to these protocols and monitoring and enforcement of the protocols must be in place for all parties. Settling funds near real time will greatly reduce risk with minimal effort/minimal cost for participants which will increase usage.

Question 6: Near-real-time payments with the features described in the second desired outcome could be provided several different ways, including but not limited to:

a. Creating a separate wire transfer-like system for near-real-time payments that leverages the relevant processes, features, and infrastructure already established for existing wire transfer systems. This option may require a new front-end mechanism or new rules that would provide near-real-time confirmation of good funds and timely notification of payments to end users and their financial institutions.

b. Linking together existing limited-participation networks so that a sender in one network could make a payment to a receiver in another network seamlessly. This option may require common standards and rules and a centralized directory for routing payments across networks.

c. Modifying the ACH to speed up settlement. This option may require a new front-end mechanism or new network rules that would provide near-real-time confirmation of good funds and timely notification of payments to end users and their financial institutions. Payments would be settled periodically during the day.

d. Enhancing the debit card networks to enable ubiquitous near-real-time payments.

e. Implementing an entirely new payment system with the features described in the second desired outcome above.

i. What would be the most effective way for the U.S. payment system to deliver ubiquitous near-real-time payments, including options that are not listed above?

The IBA task force believes the most effective and efficient delivery system exists within the principles and framework of the current UCC, ACH and debit card rails. Although there are cumbersome aspects of the current system, the notion of building a new payment system that can be adopted and implemented by thousands of banks and credit unions is not plausible within any reasonable time frame or even necessary.

The current rails do work and can be adapted and improved upon:

- Industry adoption of the Federal Reserve's enhanced ACH same day product line will be a significant ally to the cause of faster payments.
- Electronic payment orders can be a useful alternative for small businesses and their consumers that desire the optics of a check but want same day or faster settlement.
- Debit card networks offer virtual real time and possibly immediate solutions for consumers and business.
- Enhancements to the debit card system for authorization with ACH for faster settlement should be considered.
- A common set of standards allowing settlement between networks or through the Fed would be a positive step.

All of these existing rails have tremendous value to the payment system and should not be discarded. There are multiple forms of payment today and changes to near-real-time payments should continue to allow for multiple systems. The task force encourages the Fed to consider interim steps that will keep us moving toward the goal of payment system improvements.

ii. What are the likely pros and cons or costs and benefits of each option? What rule or regulation changes are needed to implement faster payments within existing payment processing channels?

iii. Is it sufficient for a solution to be limited to near-real-time authorization and confirmation that good funds are on their way, or must end-user funds availability and/or interbank settlement take place in near-real time as well?

The IBA task force believes the debate about notice versus receipt of the money is over – or should be. Consumers have not adopted the closed loop payment options with delayed payment for an unknown period of time. Adoption will most certainly come with the payment model where the money is available either immediately or in near real time.

iv. Which payment scenarios are most and least suitable for near real-time payments? (B2B, P2P, P2B, POS, etc.)

The most needed and suitable near real time payment will be in the payroll, person-to-person or the last minute and critical person-to-person business payment. This is a need for almost everyone and will be quickly recognized as an important solution to everyday household and business payment circumstances. The IBA task force believes that business-to-business could also be very useful, but size of payments could be a limiting factor.

Question 7: Some industry participants have said that efforts to make check payments easier to use, such as by enabling fully electronic payment orders and/or by speeding up electronic check return information, will incrementally benefit the payment system. Others argue the resources needed to implement these efforts will delay a shift to near-real-time payments, which will ultimately be more beneficial to the payment system. Which of these perspectives do you agree with, and why?

Electronic payment orders as mentioned above could provide a short term faster solution for those that prefer the basic check and desire the optics of a document. While the need for these short term options should not be overlooked or discounted, it is also important for the framers of this strategic payment plan to carefully weigh whether they are good short term options or will they ultimately slow the transition to more efficient electronic payment options.

Question 8: How will near-real-time payments affect fraud issues that exist with today's payment systems, if at all?

Fraud in all its forms is simply a fact of life in any conceivable exchange of value. The ability to move a payment electronically is a result of advances in technology. Likewise, technology does and will continue to provide the tools to minimize and mitigate that risk. Matching up real time sender and receiver alerts with real time or near real time payments is perhaps the best way to enhance fraud protection.

i. Will near-real-time payments create new fraud risks? If yes, please elaborate on those risks.

The IBA task force believes that the ability to settle payments faster will reduce risk. Check clearing losses have been minimized over time due to faster settlement. Regulating the participants is also key to minimizing fraud.

Question 9: To what extent would a ubiquitous near-real-time system bring about pivotal change to mobile payments?

The IBA task force believes that mobile payments have enormous potential to dramatically shift the payment landscape. Removing the constrictions of current payment methods and giving the ability to pay anyone, anywhere will be appealing for many Americans. Having the money immediately, near real time or with good funds notice available will drive adoption of mobile payments. Again, systems should be built to provide senders and receivers with various options.

Again, the task force believes the Federal Reserve Bank should not weigh in, mandate or limit pricing options. In other words, they should not discourage or mandate the same pricing models for various payment options like good funds, near real time or real time. Doing so will limit innovation and stifle investment.

Question 10: What would be the implication if the industry and/or the Federal Reserve Banks do not take any action to implement faster payments?

As stated in our introduction, the Iowa Bankers Association Board pinpointed payments as an issue of significant importance for the future of the banking industry. The IBA task force was created because bankers understand that the payment system is evolving very rapidly and failure to adapt can be fatal for the industry and harmful for consumers. We do not believe that inaction is an option.

i. What is the cost, including the opportunity cost, of not implementing faster payments in the United States?

The cost will be staggering in the opinion of the task force. The United States can and should be leading on the effort to develop a faster, safer and more efficient payment system and the Federal Reserve, in its capacity as the central bank of the United States, has to lead and/or coordinate the effort to bring all segments of the payment system together.

Question 11: To what extent will the industry need to modernize core processing and other back end systems to support near-real-time payments?

Iowa bankers, like banks around the country, utilize a myriad of core processors and many have built and implemented their own in-house processing systems. Others, through mergers and acquisitions, have maintained multiple legacy systems. But all can receive ACH, provide balance authorizations for ATM/debit card products, and have directly or indirectly adopted Check 21 processes. Even financial institutions that still operate in batch mode can increase the number of times per day they update file balances and receive ACH without additional investment. While we do not underestimate the potential costs to our membership of adopting and implementing faster payment solutions, either new systems or improvements to existing applications, we also understand it is essential for our customers so they are not forced to turn to the non-bank non-regulated sector.

i. What is the likely timeframe for any such modernization?

Bankers are capable of meeting the timeline needed for adoption. Inaction is not an option.

Question 12: Some industry participants suggest that a new, centralized directory containing account numbers and routing information for businesses and/or consumers, to which every bank and other service providers are linked, will enable more electronic payments. A sender using this directory would not need to know the account or routing information of the receiver.

i. What are the merits and drawbacks of this suggestion?

The IBA task force believes the creation of a central directory or a directory of directories is essential to any open system that connects senders to receivers without the two parties sharing critical and confidential personal financial information. The directory does not need to own, house or store the information. It should be created as a universal identification/verification model that links critical information that is securely stored and protected by the consumer's financial institution or other trusted partner.

ii. What is the feasibility of this suggestion?

It is completely feasible. The IBA task force believes a central directory is the missing link that will allow the U.S. to leverage its existing payment systems and achieve the five desired outcomes. It also lays the groundwork for all future improvements.

Question 13: Some industry participants say that check use is an enduring part of the U.S. payment system and that moving away from checks more aggressively would be too disruptive for certain end users.

i. Is accelerated migration from checks to electronic payment methods a high-priority desired outcome for the U.S. payment system? (Accelerated means faster than the current trend of gradual migration.)

ii. Please explain if desired.

The IBA task force does not believe that accelerated migration from checks to electronic methods is a high priority desired outcome. Progress towards faster, efficient, secure electronic payments that carry critical information for both the sender and receiver will continue to naturally drive the utilization away from checks and paper. Any effort to set a goal or target is ill-advised and unnecessary. Building an open and ubiquitous payment solution that meets the objectives set out in the Federal Reserve's Consultation Paper will bring with it the desired results.

iii. If yes, should the Federal Reserve Banks establish a target for the percent of noncash payments to be initiated via electronic means, by a specific date? For example: "By the year 2018, 95% of all noncash payments will be made via electronic means."

iv. What is the appropriate target level and date?

Question 14: Business-to-business payments have remained largely paper-based due to difficulties with handling remittance information. Consumer bill payments also are heavily paper-based due to the lack of comfort some consumers have with electronic alternatives. In addition, many small businesses have not adopted ACH for recurring payments due to technical challenges and/or cost constraints. The payment industry has multiple efforts underway to address these issues.

i. To what extent are these efforts resulting in migration from checks to other payment types?

ii. What other barriers need to be addressed to accelerate migration of these payments?

iii. What other tactics, including incentives, will effectively persuade businesses and consumers to migrate to electronic payments?

A conventional paper check matched to an invoice is a common small business book keeping and payment system practice. Habits and personal preferences that are easily understood tend to be slow to change until a more efficient and better alternative becomes available and undeniable. Forcing such change would be counterproductive. A better alternative is to provide a faster, efficient, data rich electronic solution that will be adopted over time.

iv. Which industry bodies should be responsible for developing and/or implementing these tactics?

The IBA task force believes that consumers trust their bank with their payment information today because it is well understood, well regulated, and well capitalized. We also believe that the U.S. central bank should lead and coordinate the effort.

Question 15: To what extent would the broader adoption of the XML-based ISO 20022 payment message standards in the United States facilitate electrification of business payments and/or cross-border payments?

International standards are essential to enhancing the global and cross border payment system. This will be a difficult proposition but it is critical to increasing trading partner confidence and expanding international trade. However, in the short term, efforts should be focused on the domestic person-to-person and person-to-business payment system.

Question 16: What strategies and tactics do you think will help move the industry toward desired outcome four - consumers and businesses have greater choice in making convenient, cost-effective, and timely cross-border payments?

Consumers are currently faced with evaluating multiple closed loop payment options with new choices announced almost daily. The fact that they are closed loop will continue to inhibit utilization with some temporary winners and many more that will fade away. The goal is to advance an open electronic payment system using existing but improved rails. The success will hinge on the central bank's leadership that provides the financial institution based conduit for end to end payments. Base standards provide a way for the industry (new and old) to do business faster, safer and at less cost.

Question 17: Payment security encompasses a broad range of issues including authentication of the parties involved in the transaction, the security of payment databases, the security of software and devices used by end users to access payment systems, and security of the infrastructure carrying payment messages.

i. Among the issues listed above, or others, what are the key threats to payment system security today and in the future?

A good funds guaranty is an essential component of the payment system that can only be achieved with reliable, confirmed identification and verification of users at both ends. The solution will evolve but will ultimately be a new paradigm of identification using ever advancing specific and unique personal identification technology.

ii. Which of these threats are not adequately being addressed?

The IBA task force does not believe that any of the threats are being adequately addressed in the non-bank, non-regulated environment.

iii. What operational or technology changes could be implemented to further mitigate cyber threats?

Question 18: What type of information or threat awareness and incident response activities would be useful for the industry?

Electronic alerts are common place today and effective.

i. How should this information be made available?

The Federal Reserve alert service is a good example of how alerts can be made available in a valuable and timely fashion. This system has been tested and proven and provides a good foundation for a threat awareness and incident response system.

Question 19: What future payment standards would materially improve payment security?

i. What are the obstacles to the adoption of security-related payment standards?

The obstacles to implementation of better standards are cost, business case, and habits. The guaranty of good funds is a risk based business and the banking industry does it based on a risk/reward pricing structure.

Question 20: What collaborative actions should the Federal Reserve Banks take with the industry to promote the security of the payment system from end to end?

The Federal Reserve has undertaken a serious and genuine collaborative effort to define a payments strategy that makes sense for U.S consumers, businesses, and stakeholders. The Federal Reserve's continued leadership is critical in bringing together the financial industry to achieve the desired outcomes. Stakeholders will not all agree but the goal has to be an open, affordable, fast, secure and easy end to end payment system.

