# Federal Reserve Banks Financial Services
# Payment System Improvement
# Public Consultation Response

Submitted by:
**Thomas McCole**

## Q1. PAYMENT SYSTEM GAPS AND OPPORTUNITIES

I am in general agreement with the identified gaps and opportunities in the Public Consultation Document as it proposes to strategically focus on **end-to-end** improvements to our retail and commercial payment infrastructure. To remain commercially competitive both domestically and globally, the US payment system should create a new process where payment transactions afford minimal risk to the payer and payee, are processed in near real-time, in a secure manner by a trusted entity; i.e. the Federal Reserve/NACHA. The new process should concentrate clearly on the end-to-end participants and not be held hostage by the profit-seeking parochial interests of financial and processing intermediaries. This new payment system should be developed, implemented, and managed by an independent governing entity that shall remain so, and not follow the commercial conversion example of the credit card brands from associations to public corporations. Moreover this independent entity should not be subject to the acceptance and/or commercial motives of large financial institutions.

## Q2. DESIRED OUTCOMES OF PAYMENT SYSTEM IMPROVEMENTS

The velocity of new payment and even alternative currency models would clearly demonstrate that the market is searching for a lower cost payment method than the existent credit/debit card system. Padiant, Dwolla, Isis, PayPal, and Bit Coin among a plethora of others are all trying to gain acceptance. The inherent issue for these alternative methods lies in universal acceptance mandate of both merchants and consumers simultaneously to succeed. This is difficult and expensive for all but the competitors with the deepest pockets and the long-term commitment to win.

## Q3. ADDITIONAL OUTCOMES TO PURSUE

Any new payment system should be governed and managed by a non-commercial entity, i.e. the Federal Reserve, NACHA, or new entity entirely. The card brands as example, converted from an industry association structure governed by their member banks to a for-profit public corporation. They now compete directly with their customers while still setting the rule. This is viewed inside the industry as the proverbial unfair advantage. The new payment system should remain "Swiss" in the sense of perpetual neutrality. This is essential to insure the long-term payment system integrity and eliminate the fear for industry participants that a future competitor might ultimately govern them.

As a side note, I have already suggested To the Atlanta Federal Reserve to create and build a brand for a new payment system. This "branding" concept has cleared the legal department with no objections.

## Q4. UBIQUITOUS PARTICIPATION OUTCOME

The successful rollout of an entirely new, near real-time payment system will require the concerted effort of many if anything near ubiquitous participation is to be achieved in a timely manner. The process, costs, risks, and benefits, must be explained and coordinated with financial institutions, acquirers, gateways, merchants and most importantly consumers. In my view, the scope of this effort shall mandate a non-commercial entity to lead and develop and control this system.

It is a passive exercise with no predictable outcome to wait for the near real-time market to evolve by commercial efforts. Participant ubiquity implies that all merchants, large and small, should get a seat at the standards design table and not just the top 20 merchants.

## Q5. DESIRED OUTCOME FEATURES

These 5 features are all critical for the successful implementation of a new payment system. Additional features might include daily, monthly, and year-to date transaction reporting, exception transaction reporting for failed transaction, and reason codes for transaction failures. Reporting should also include

## Q6. FEATURES CONTINUED

i. The best way to implement a new US payment system is through a Federal Reserve branded mandate where the rules and fees are set for the participant banks, merchants and consumers.
ii. The rule changes would include verification of good funds, consumer/merchant reversal process criteria, and potentially risk management transaction amount thresholds predicated on SIC codes.
iii. To start, I believe authorization and confirmation components would suffice for a one-year trial. Currently credit/debit card batches are next day or longer and most merchants appear satisfied with that window.
iv. The most suitable transactions are B2B, P2B, and POS albeit with some type of consumer protection via a refund/reversal process.

## Q8. FRAUD RISKS

Near real-time payments do have the potential for new bi-directional fraud risks for both merchants and consumers. Consumers need the ability to return merchandise that is unsatisfactory for any reason. Merchants conversely, must have the confidence of a good payment before delivery of goods and services.

## Q9. MOBILE PAYMENT CHANGES

Mobile payments are nascent and the early adopter consumers should not be impacted. Merchants will enjoy a lower transaction fee and may promote the technology to their customer base.

## Q10. IF THE FEDERAL RESERVE DOES NOT ACT

MCX, the Clearing House or some other entity will create standards that may favor their own interests and/or preclude small merchants from participating at the same transaction costs.

## Q11. SYSTEMS MODIFICATIONS

POS systems and payment terminals will have to be modified to send the account #s or other account identifier to a host and process the authorization or decline. Additionally they will have to monitor the funds settlement and marry it to the transaction batch. They will also need to implement a refund/reversal exception transaction process and a settlement batch report.

Acquirers will have to develop the ability to generate the ACH request to the Fed and handle their side of the aforementioned transaction process.

The development timeframe should take less than 6-9 months if the vendors and the acquirers are properly motivated.

## Q12. CENTRALIZED DIRECTORY

The centralized directory concept is quite interesting and would ultimately be the best methodology in my view. That said it would be a fundamental paradigm shift that would require a huge database effort, new security measures and may follow the Healthcare.gov debacle over the cliff.

## Q13. MIGRATION FROM CHECKS

I can visualize a bumper sticker stating, “you can pry my checkbook from cold dead hand,” from the “Boomer” and older generation Americans for the foreseeable future. Near real-time transactions will be driven by business-to-business transactions and the “Millennials.”

## Q14. INCREASING MIGRATION

Merchants and businesses in general will embrace near-time payments predicated on the substantially lower cost than that of cash-back/loyalty/affinity credit cards and corporate purchase cards. Some cardholders will likely not give up the “points” and purchase data that come with these card types unless incented by merchants.