December 13, 2013

The Federal Reserve Banks
Submitted via comment@fedpaymentsimprovement.org

RE: NEACH – Response to Federal Reserve Banks' Payment System Improvement Paper

NEACH would like to thank the Federal Reserve Banks for the opportunity to respond to the Payment System Improvement Consultation Paper. NEACH is a regional payments association (RPA) with more than 500 member banks and credit unions as well as business, merchant, vendor, and other payments stakeholders across the six New England states. We have addressed our comments only to specific questions that we believe are most relevant to our membership.

Sincerely,

Breffni McGuire

Vice President,
NEACH, the New England ACH Association

GENERAL

Q1. Are you in general agreement with the payment system gaps and opportunities identified above?

NEACH generally supports the Federal Reserve Banks' (FRB) initiative to create an overall vision for payment system improvement that meet the needs of stakeholders and end-users for speed, efficiency, and security from originator to recipient but think that the opportunities need to be more clearly delineated for all end-users – businesses/merchants and government entities as well as consumers. The paper spells out the opportunities and gaps for consumers most especially in regard to near real-time payments but is much less clear when it comes to the needs of small businesses and large corporates; the latter gets little attention in the paper. The U.S.

Treasury (FMS), which is the largest constituent in the ACH Network, is conspicuous by its absence from the discussion.

NEACH generally agrees with the specific opportunities and gaps listed but are concerned that there is an unintended bias based on those included in the paper as well as a bias toward *consumer* end-users. Additionally, there appears to be an underlying assumption that all end-users prefer near real-time information in all cases. The absence of data-points and sources for some statements makes agreement (forming a Yes/No decision) impossible. The paper also omits a thorough discussion of cost or pricing. It is one thing to ask consumers what they want; it is another to ascertain how they would really use near real-time services; and it is something else again to find out if consumers would be willing to pay for such services or what trade-offs there might be among speed, efficiency, and security based on price or other characteristics. Additionally, the paper does not provide enough information about settlement nor explore sufficiently the difference between near real-time payments and real-time information and the value each offers to a given type of end-user. We would like to see more research and concrete data that deals with these issues from the perspective of all end-users.

Q2. Are you in general agreement with the desired outcomes for payment system improvements over the next 10 years?

NEACH generally agrees with desired outcomes 1 through 4. Although we do not disagree with the fifth outcome, we think it is not sufficient. According to a new survey, U.S. consumer confidence in banks has just returned to pre-recession levels. Ten years forward, public confidence should not be limited to Federal Reserve financial services but should apply to the payments industry providers as a whole, including financial institutions, third parties, and nonbanks. Nonbanks offering the same type of payment services as banks and credit unions should be brought under the same regulatory regime. Public confidence is created in the market and by the payment system providers – and the regulatory framework is an inherent factor undergirding that confidence.

There is an assumption that the future situation is based on good-funds model, credit payments. If this is true, it should be made explicit. One outcome from this would be a new business model, where NSF fees no longer exist. The revenue implications of this (and other) improvements should be considered.

Q3. In what ways should the Federal Reserve Banks help improve the payment system as an operator, leader and/or catalyst?

We believe that the FRBs have a role as a leader and a catalyst or as an operator but that all three together could lead to a conflict of interest that is not in the best interests of all payments stakeholders including end-user consumers, businesses and merchants, and government entities.

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The FRBs are to be commended for taking the lead in this discussion about improving the payment systems, but the Board of Governors, the CFPB, and other regulators have a stake in the discussion and could play similar leader/catalyst roles. (The CFPB, through its rules, is already reshaping consumer-initiated cross-border payments.) The operator role is much less clear. If the industry determines that a new payment system for near real-time payments should be developed, it does not follow that the FRBs should become an operator for such a system. Modifications of existing payment networks presumably would be made by the current owners of such systems.

Ubiquitous near-real-time payments

Q4. 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?**
This question is impossible to answer because the question is not clear. "Accurate" is inappropriate when asking respondents to speculate about what "some" unidentified parties have stated.

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

Q5. 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?
YES, but there are many others.

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Please explain, if desired.

These features are clearly important to some end-users. Business and government entities, as well as some consumers, however, have other, different requirements. It would be helpful for the discussion to include information about existing models as well as the potential interplay among the various systems and/or system attributes. It would seem useful for the FRBs to assess existing systems for near real-time payments to discover which features are important to specific end-users and what works in different contexts. The last thing the U.S. payment system needs is an additional limited-participation payment system with many of the same features that already exist in current systems. To date, each new payment system in the U.S. has been additive and none has disappeared – unlike the situation in other, particularly developing economies, where new payment systems can 'leap-frog' ahead without the drag of legacy payments infrastructures.

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

- Validation of the account number (or number underlying email, mobile number) so that exceptions are kept to a minimum.
- Information and payment should travel together, except in situations where some information might also precede payment settlement
- Standards
- Guiding regulations
- Ability to choose a value date (refer to #e)
- Settlement
- Near real-time information not necessary real-time payments (something along the line of a corporate 'advice to receive' that provides information to the recipient before the payment is received.
- Ability of small FIs to participate fully in the in the system. End-users, especially consumers, will be less well served if smaller institutions cannot participate or drop out of part of the payments system.

Q6. 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.

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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. 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?

- A range of alternatives driven by the market and the private sector is important. Industry-wide solutions are essential to satisfy the requirements of all types of end-users. The FRBs have no control over most of the options listed, although certainly as an ACH Operator, the Fed should assess how it can support the ACH Network in this regard. We do not believe that "modifying the ACH to speed up settlement" is sufficient to meet the stated goals of speed, efficiency, and security, which should be tackled together rather than separated into piecemeal steps. ClearXchange may serve as a model for actions in this regard, and NACHA has opt-in products that should also be assessed as models. Then, too, there are other payment mechanisms that rely on ACH settlement. All should be examined in the context of both current and future needs, among them near real-time payments.

ii. What are the likely pros and cons or costs and benefits of each option?

a. 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?

This is not an either / or situation. A solution set should support both alternatives. In the funds transfer world today, some institutions offer 'advice to receive' type services that notify corporate customers of subsequent funds delivery (availability and settlement). The wholesale payments industry has been talking for years about implementing 'logistical' services for payments that are comparable to those offered by merchants that allow senders and/or recipients to be able to track items at every point in the ordering, processing, and delivery chain.

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

All may be suitable to the model but not to the market. POS transactions today, for example, are not typically credit payments.

Q7. 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.

i. Which of these perspectives do you agree with and why?

We are not supportive of EPO or similar schemes to digitize rather than replace paper checks. We already have systems, statutes, and regulations governing electronic payments, retail and wholesale, that are widely-used, well-understood, and provide protections for consumers and businesses.

Q8. How will near-real-time payments affect fraud issues that exist with today's payment systems, if at all?

i. Will near-real-time payments create new fraud risks?

YES

If yes, please elaborate on those risks.

Fraudsters will find a way to access whatever information they need to perpetrate fraud, whether going after account numbers, email addresses, telephone numbers, or some combination of this information. There is no solution that will be completely fraud-proof, so financial institutions and other providers implement controls with each new typology and payment mechanism. Our expectation is that the industry will react to mitigate new risks as new threats emerge in near real-time payment channels.

Q9. To what extent would a ubiquitous near real-time system bring about pivotal change to mobile payments?

This question is the wrong way around – what changes will mobile technology foster in the payments arena relative to real-time solutions, settlement, regulation, etc.? We believe that mobile and other emerging technologies / services will continue to fuel the desire for near real-time payment services.

Q10. What would be the implication if the industry and/or the Federal Reserve Banks do not take any action to implement faster payments?

This is a complicated question worthy of further study. The "industry" comprises just under 7,000 banks and more than 7,000 credit unions who offer different types of payment services to diverse groups of end-users. The payments business is currently experiencing profound change on many levels, including consolidation and concentration of payment volumes at the top end of the market. Implications will be different across the industry and will differ in impact and timing.

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

Q11. To what extent will the industry need to modernize core processing and other backend systems to support near-real-time payments?

Again, define "industry" and include the wide variety of third party providers and non-banks in the market. It is impossible to answer this question without more definition or specific proposals on the table.

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

Q12. 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?
ii. What is the feasibility of this suggestion?

Electronification

Q13. 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.)

Please explain, if desired.

This is already being driven by the market and taking place today. Fewer checks are being written and others are being converted in a way that accelerates migration. The ACH Network introduced both check conversion and electronic check applications at the turn of this century. In the check world applications such as RDC and other types of check capture are pervasive. (Some state laws impact this migration.)

ii. 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."

No, the private sector should drive the timeframes. The example cited is much too general: which 5% would be allowed to be paper by 2018? Who decides?

iii. What is the appropriate target level and date?

Q14. 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?
iv. Which industry bodies should be responsible for developing and/or implementing these tactics?

Cross-border payments

Q15. To what extent would the broader adoption of the XML-based ISO 20022 payment message standards in the United States facilitate electronification of business payments and/or cross-border payments?

Q16. 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?

The CFPB has already put a stake in the ground relative to consumer-initiated cross-border payments. We believe that the private sector and the market can and should drive the industry forward, providing end-users with efficient, secure, and timely payment services.

Safety

Q17. 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?**
ii. **Which of these threats are not adequately being addressed?**
iii. **What operational or technology changes could be implemented to further mitigate cyber threats?**

The private sector will develop and implement new technology and security solutions for all payment mechanisms, near real-time or not. Regulatory guidance, too, will continue to guide financial institutions on safety and soundness issues. The Administration, Congress, and financial services sector entities are actively engaged in cyber security threat mitigation. NACHA has been involved deeply in cyber issues. In addition, after the 'President Obama will pay your bills' scam, the ACH Network is re-examining the ability of participants to handle other Internet-based threats.

Q18. What type of information on threat awareness and incident response activities would be useful for the industry?

There are already private (FSSCC, FS/ISAC) and public (FBIIC) sector entities engaged on this critical issue.

i. **How should this information be made available?**

Q19. What future payment standards would materially improve payment security?

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

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Q20. 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 FRBs work closely with systemically important payments providers and other major stakeholders. The FRBs could engage with small financial institutions through industry organizations and their own initiatives to help ensure that threats and mitigations are more thoroughly communicated and understood at least among the providers if not end-to-end directly. (Financial institutions are better positioned to deal directly with their customers or members.).

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