

Fed Consultation Paper – Association for Financial Professionals (AFP) Response

Q1: Are you in general agreement with the payment system gaps and opportunities identified? What other gaps or opportunities not mentioned in the paper could be addressed to make improvements to the U.S. payment system:

Payment systems in many other countries have moved or are moving toward ubiquitous near-real-time systems while the pace of change in the U.S. has been very slow. This has created a gap where payments in the U.S. to a large extent continue to be processed by paper checks rather than more efficient and electronic methods. Sending and receiving payments electronically should be preferred as they are easier and more reliable to process. They are also more cost-efficient and can be handled without manual intervention which can improve Straight-Through-Processing (STP). Other benefits of electronic payments include increased fraud protection and better timing of funds.

Another gap, or pain point, are cross-border payments. According to the 2013 AFP Electronic Payment Survey 65% of cross-border payments are sent by wire which is an expensive method. Only 5% are made by checks which indicate how inefficient and non-interoperable checks are for international trade.

Based on this, one issue that should receive more focus is the development of a U.S. payment standard that is interoperable, or at least has the potential of being interoperable in other important parts of the World. The most likely standard to focus on should be the ISO20022 as it has been implemented in several other international markets.

Adoption of the ISO20022 standard in the U.S. will require a solid business case. This is a different approach than was taken for the implementation of the standard in Europe (SEPA). However, there are probably some valuable lessons from implementation of the standard in other parts of the World.

Q2: Are you in general agreement with the desired outcomes for payment system improvements over the next 10 years? What other outcomes should be pursued?

The time frame of 10 years is probably realistic. However, the approach should aim to be very active and feel some haste. The U.S. should be the driver of development in this field.

The desired outcomes are good, but should not stop at domestic interoperability but international as stated in desired outcome #4. Obviously the challenges of attempting this are much greater but given the reality of the situation with growing globalization this is an issue that is not going away. It will probably be better to include these

challenges from the start. For example, learning from the implementation efforts of new payment systems internationally could draw some parallels.

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

The Federal Reserve Banks should act as a leader. It is the only body with enough weight to drive through the necessary changes. Does the Federal Reserve have a mandate to do so? If not, how to obtain a mandate is another question which could be addressed.

Q4: Which of these perspectives is more accurate?

Implementing new systems for near-real-time payments will require coordinated action by a public authority and industry groups. If not, the ubiquitous nature of the system may get lost. If current payment services develop their own systems there is no certainty of efforts to create interoperability. Competition may lead to the opposite.

A solid business case for a new system will be needed for adoption to take place.

Q5: a. Ubiquitous system:

Yes, very important

b. Sender doesn't need to know the bank account information of the recipient/

It is a little unclear why this is important given how many payments that are currently done by checks, a payment system that discloses all of this information, and more, very openly. If it is a real barrier then a Directory containing the BASIC bank information may be a solution.

C: Confirmation of good funds is made at the initiation of the payment

Again, it is unclear why this is important given the popular and extensive use of checks where this is not a feature, but as companies look to electronify their payables, this will become more important

D: Sender and receiver receive timely notification.

It is a nice feature but would the potentially higher cost for such feature work against the business case?

E: Funds debited from the payer and made available in near-real time

Yes, important

One thing to keep in mind is that any additional functionality is adding cost and complexity of the system. In the corporate world added fees or costs related to payments is usually a very difficult sell unless a solid business case can be presented.

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: See paper a, b, c, d, e.

i: Tweaking current systems here and there is probably not going to be enough. On the other end of the spectrum is the development of an entirely new payment system which may not be a realistic option due to high cost and other challenges. Modifying ACH (c) and creating a separate wire transfer-like system (a) might be one of the best options. If ACH could be coupled with a workable remittance information feature (that excludes manual intervention) in a globally interoperable format (ISO2022) it may prove to be the best way to proceed.

lii: Yes it is sufficient, at least initially.

lv: All payment scenarios should be considered with volume of those payment types identifying the priority.

Q7: Making check payments easier to use....?

Focusing on making checks easier to use will delay a shift to near-real-time payments and will in the long run work against the development of the U.S. payment system as a whole. Any development of the payment system should include standardization and interoperability. Checks and the check standard are outdated and not globally interoperable (Only 5% of the respondents in the 2013 AFP Electronic Payments Survey indicate checks as a payment option for cross-border payments). It would be better to focus the resources on a near-real-time system that is also interoperable with payment systems in other parts of the World. Therefore, instead of electronifying checks and speeding up electronic check return information, etc, a better focus would be to spend on direct electronicification of payments and helping make the business case for corporates as the end users.

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? If yes, please elaborate on those risks.

Current fraud prevention methods may have to develop additional functionality. One example is conversion of checks to ACH where bank systems should bridge across check and ACH. For example, Positive Pay notification must be bridged for items converted to ACH and include all necessary information.

With near-real-time payments fraud will also happen quicker. There will be a need for real-time, or same-day bank fraud detection systems to identify suspect wire and ACH items.

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

The rapid pace of the development of mobile payments and not having a defined standardized payment format or definitive market leaders makes it very difficult to predict the future scope in this field. However, the mobile trend seems to gain in importance and mobility should therefore be considered in any payment system development.

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

The U.S. is behind other markets that have moved on to more efficient electronic payment systems. If nothing is done, the U.S. may lose out in international trade. In a recent unscientific poll taken during the AFP Electronic Payments Webinar, 42% of the respondents indicated U.S. businesses will probably be missing out on international trade due to high utilization of checks, 5.8% indicate a definite loss of international trade, 13% are not sure while 35.5% believe indicate no major losses. Only 3.6% believe there would definitely not be any losses. There is a risk potential trading partners overseas will be reluctant to do business with U.S. corporations if the payments process and settlement are going to be a barrier. They might instead chose trading partners located where making payments will not create extensive cost, time lag and other administrative barriers.

Q11. To what extent will the industry need to modernize core processing and other backend systems to support near-real-time payments?
i. What is the likely timeframe for any such modernization?

The Wire Transfer Extended Remittance Information supports many of the features that would be necessary in a more modernized system. However, according to the 2013 AFP Electronic Payments Survey corporations are very sensitive to making necessary investments and/or paying additional transaction fees. According to the survey 53% say they are not willing to make the investments for sending wire payments with ERI, 55% for receiving. For fees 66% say they are not willing to pay any additional fee for these payments.

Based on this the time frame may not be as important as the ability to provide this functionality to no or a very low cost.

Q12: Centralized directory...?

Given how willingly businesses disclose this information by using checks as a payment method the first question should really be why and what the real need for such a directory is. Should there be a real need such a directory should not try to do everything. For it to be used it has to be very low cost and very easy to use. It should just be a directory of the most vital information, not a payment platform. The approach therefore has to be focusing on simplified solutions, not complex functionality. However, data security and ownership will be extremely important or adoption will fail.

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: Yes, an accelerated migration from checks to electronic payment methods is a priority

ii: There is a risk the gap in payment system efficiencies to other countries will expand even further should we decide to keep an outdated payment system using checks.

lii: A target is probably not the best way to go. Migration has to be business driven and the most effective way for that is making check use more expensive by charging higher processing fees for cashing checks and lowering the cost of electronic means. If there is a business case due to higher cost for check use convincing customers and suppliers of migrating to electronic payments will be much easier.

Q14: B2B payments have remained largely paper based due to difficulties with handling remittance information...

ii: ACH remittance information deficiencies have to be addressed. If High volume, low value networks are to be utilized.

iii: Higher cost for handling checks is probably more effective as an incentive.

iv: The Federal Reserve should obtain a mandate in order to charge higher processing fees, but ultimately this is between the customer and their banking provider. The Fed should encourage the transparency in the process so that the business case to be built by both corporates and banks is as clear cut as it can be.

Q15. 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?

Since ISO20022 payment message standards have been or is being developed in other parts of the World there is much to be gained by adopting the standard in the U.S. as well. By using ISO20022 for a domestic standard it could also be globally interoperable which could facilitate huge savings in infrastructure and standards maintenance.

Q16: What strategies and tactics do you think will help...?

Focusing on the business case – higher cost for inefficient payment methods will help moving in the right direction.

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?

Check fraud needs continued attention. Checks display very vital financial information and are therefore very vulnerable when it comes to theft. Even if a check is canceled or blocked the information is still openly displayed and can be used for other fraudulent activities.

As payments are moving to electronic formats the security issues going forward will also be electronic in nature. So the security of payment databases, financial information directories, software and also terminals for cards, etc. is very important.

The introduction of EMV could provide added fraud protection for card-present transactions. However, the technology has been around for a number of years and may not be an optimal solution, especially since it doesn't address card-not-present transactions. By using a shift in liability from the card issuer to the merchant for fraudulent transactions may drive a quick adoption but is viewed very negatively by merchants as they will be forced to make expensive investments in new terminals, etc. Also, as the EMV technology may be outdated in a fairly short time frame there is a risk additional investments by merchants will be necessary. A better solution may instead be to leapfrog to a more modern technology, whether it be mobile or something else.

There also remains the threat of cyber fraud as payments channels such as credit cards continue to evolve. Especially fraud related to card-not-present purchases online needs to be addressed. Card-not-present transactions have been identified as one area where credit card fraud may migrate due to the implementation of EMV. Solutions should include technology such as "Verified by Visa" and Mastercard's "SecureCode" where added layers of security are placed on card-not-present purchases online.

Protection of financial data and databases held by organizations must be addressed. . The latest major breach at Target should be used as a case study as to how it happened and how to futureproof payment systems in guarding against fraud and elaborate system breaches in light of having being in compliance with PCI standards.

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

There should be a general audit of current security measures and based on that a coordinated effort to address the weakest links.

One security measure that has not been addressed adequately is authentication for credit card transactions. With no ID check and only a signature (only for amounts above a certain limit) there really is no way for a merchant to verify the authorization for the transaction. A stolen credit card could for that reason easily be used for a number of transactions before being reported and blocked.

Checks present a high security risk by their very nature. Blank checks display vital information such as the account holders home address, bank account number and routing number to the bank. A stolen check book can easily be used to produce fraudulent checks that look authentic. Only a signature is needed and the receiver is not likely to know a fake signature from the

authentic. Authentically produced checks by the correct account holder also present a high risk. In addition to the bank information displayed on the check an authenticated check also displays the account holders signature and handwriting. Criminals can not only use the identity information displayed on a stolen check but also duplicate the signature and handwriting for producing other fraudulent checks and/or documents.

Card-not-present transactions in the U.S. also present a risk not adequately addressed since authentication of an online transaction is usually still not needed, other than having the billing address available. In other parts of the World additional authentication of card-not-present transactions is often required. By using already existing technology such as Verified by Visa and SecureCode (MasterCard) a card-not-present transaction is protected by an additional layer of security. Adding this kind of protection should also be taken into consideration for the U.S.

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

See above

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

Information on threat awareness must be fast and coordinated from a central information point/organization.

Sharing of data between industry participants. Information on active fraud and security issues should have forums, or user groups where participants can discuss current various topics and potential solutions. Simplicity is important. These forums should be easy to use. Focus should be on the content and quality of the discussions. The goal of these groups should be to keep participants engaged and active contributors on almost a daily basis.

i. How should this information be made available?

A central website.
Secure online login to user groups.
Media.

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

Having a uniform standard will help in addressing security issues. By using ISO20022 standard security issues can be addressed from many different perspectives as it is globally interoperable.

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

Difficult to coordinate the efforts of many different participants and come up with a solution that fits all.

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?

Work through interactive conferences where all stakeholders can provide unique insights and perspectives. Aligning the payment system regulation, compliance and oversight into as few organizations as possible for quicker adaptation, rule enforcement and fraud targeting.

Q21. Please share any additional perspectives on U.S. payment system improvements.