

Payment System Improvement Public Consultation Paper December 2013

The Electronic Funds Transfer Association (EFTA) is pleased to respond to the request of the Federal Reserve Banks (the Banks) for comments on the Public Consultation Paper on U.S. payment system improvement. The EFTA is an inter-industry trade association dedicated to the advancement of electronic payments and commerce. EFTA members include financial institutions, electronic payment processors, electronic payments networks, hardware and software manufacturers, emerging payment companies, technical consultants, government agencies and other significant players in the payments system.

EFTA is a source of objective information for the payments industry and seeks to inform the public discourse on issues of importance to EFTA members and the electronic payments industry. EFTA has a long history of working with Congress and government agencies on ways to improve the payments system.

To prepare this response to the Public Consultation Paper, EFTA conducted a survey of its nearly 300 members on the issues raised in the paper. EFTA member responses inform our opinions set forth below.

The Banks' vision as outlined in the Public Consultation Paper appears to follow the global trend toward near real-time payments. Australia and the United Kingdom are often cited as innovative in faster funds movement. EFTA members, by a nearly four-to-one margin, agree that real-time payment is a desirable goal for the U.S. payments system to achieve.

The Public Consultation Paper raises three important questions on which this paper focuses:

1. Is this a desirable outcome?
2. If so, who should lead this effort?
3. What are the funding investments necessary to achieve near real-time payments?

EFTA will expound on these issues in this response.

EFTA believes the Banks are in a unique position to provide thought leadership and to work with diverse industry participants to help set the direction of, and achieve improvements in, the payments system. These improvements should be market-driven and focus on system integrity, consumer protection and privacy, product choice, and a consistent regulatory structure.

EFTA has been silent on how "fast" or "real-time" electronic payments should be made. EFTA contends that electronic payments can only flourish in an environment where consumers are assured of the safety and security of their funds and accompanying data. More than 60 percent of our survey respondents voiced concern over the issue of fraud in real-time payment systems.

Effective risk management and fraud prevention are also essential elements in the real-time paradigm. If the move toward near real-time payments adversely affects any safety, security, risk management and fraud prevention aspect, consumers and the payments industry may retreat. Consumers continually demonstrate a willingness to sacrifice speed and convenience for safety and security, especially when it comes to the transfer of their funds.

The Public Consultation Paper recognizes that the U.S. payments system is undergoing dynamic change. The Banks also noted that this is due to technology, innovation and “evolving end-user expectations.”

However, the role of regulation cannot be underestimated as a factor in how the payments system will evolve over the next several years. The most prominent example is the legal uncertainty over the Federal Reserve Board’s Regulation II, implementing the so-called Durbin Amendment in the Dodd-Frank Act. For most EFTA members, the rate cap on debit card interchange and associated pricing restrictions is a dangerous and unprecedented interference in the market, and rewriting merchant routing requirements and network rules is an exceedingly difficult operational issue, with very little benefit accruing to consumers as a result. .

EFTA members are also working through business and operational issues related to the adoption of smart card technology in the U.S. In particular, adoption of EMV, a secure global standard for credit and debit cards based on chip technology, has been problematic. The business case for deploying this technology and infrastructure in the U.S. remains uncertain.

The payments system is subject to an ever-increasing number of mandates -- from both the public and private sector. These mandates have dramatically increased compliance costs and stretched resources at a time when legislation and regulation have significantly reduced traditional revenue streams.

With respect to the implementation of real-time payments in this environment one EFTA member commented that:

[The] timing couldn’t be worse. We are just tip-toeing out of the recession and that’s in the midst of massive financial services regulation in the way of IRC 6050W, overdraft regulations, the CARD Act, Dodd-Frank.... There doesn’t seem to be any driving force as to why real-time payments are necessary *now*.”

Any regulations coming out of this effort should be applied in a consistent manner. This will help level the playing field and strengthen consumer protections. The cost of compliance ought not to be a disqualifying reason for moving toward near real-time payments.

History has proven that financial services companies and payment providers will make the investments necessary to meet a consumer demand--when the cost of doing so is recaptured through a rational business case analysis.

Four out of five respondents in our member survey said that the Banks should conduct a cost-benefit or investment return analysis on any new payments system. Another respondent opined that any analysis needs to “include the costs that all actors will need to expend and where those costs will be borne.” The respondent noted that as with all innovations of this magnitude, there will inevitably be a cost to consumers. Such costs should not exceed the value consumers derive from improvement in current payments mechanisms or the introduction of new payments systems.

Debit and prepaid cards are a prime example of cost-justifiable products that were developed through promotion by the private sector while meeting consumer needs. Hence, EFTA continues to believe that payments system innovation is best achieved when the private sector responds to consumer demand.

EFTA is in general agreement with the Banks’ analysis of gaps and opportunities in the current U.S. payments system. U.S. consumers do enjoy choice when making payments: they want the ability to pay with cash, check, cards, wire transfer, online and mobile bill payment and through the Automated Clearing House (ACH) system.

While nearly 80 percent of EFTA members agreed with the Banks’ definition of “real time,” others noted the difficulty in trying to define the term. One respondent raised the issue of ecommerce transactions: If a consumer “pays” for three items over the Internet and two ship immediately but one is back-ordered and that portion of the transaction doesn’t leave the consumer’s account until the third product ships, is that a “real-time” transaction?

One respondent actually questions whether imposing a definition of real time is itself appropriate. He advised that the Banks would be better off determining what is possible and setting that as the goal.

Therefore, EFTA recommends that the Banks provide greater clarity regarding the definition of near real-time payments. EFTA members believe that without clarifying the goal through definition, there are too many open-ended questions regarding the Banks’ goals. What “real-time” transactions end up being will affect how EFTA members look at factors like cost, fraud, and implementation timeframes.

The Public Consultation Paper does ascribe certain “features” to near real-time payments (e.g., masked account details). Certain news reports on real-time payments in other countries suggest these payments may not necessarily be in real time (*see [Digital Transaction’s Faster Payments June 2013 cover story](#)*). Managing consumer expectations on near real-time payments will be as challenging as implementing such a system.

More than 60 percent of our surveyed members say that the private sector should take the lead in implementing real-time payment systems. One respondent said that most of the decision support that the Banks will need has to come from the private sector under any circumstances.

However, a number of members responded that to be effective, the movement toward real-time payments will have to be a collective effort. Another noted that “no single entity” will be able to

prescribe a solution. Another said that both the Banks and the payments industry would have to join forces to accomplish such a daunting task.

EFTA believes that payments system innovation should be market driven. However, respondents were clear about their support for the Banks having a strong role in the project. One commented rhetorically, “If not the Fed [playing a leading] role, who could pull the different factions together?”

EFTA supports the Banks’ conclusion in Desired Outcome 1; namely, that “A collective and collaborate approach to improve the payment system will significantly increase the probability of successful improvements.” EFTA pledges to keep an open dialogue with the Banks, its members and other financial services trade groups in order to achieve the vision of near real-time payments.

The Public Consultation Paper points out that “funding” challenges for the financial services industry may be an impediment to realizing near real-time payments in the next five to ten years, particularly given the rising compliance costs and reduced revenues mentioned earlier.

A related issue raised in the Public Consultation Paper is whether a new real-time payments system would need to cannibalize one, two or more current payment channels to be successful. The paper suggested that “more aggressive actions” may be needed to move consumers from checks to “ubiquitous electronic payment alternatives.”

For this reason, 70 percent of EFTA members believe that the real-time solution will be achieved by enhancements to existing payments infrastructure, rather than through development of a new payments channel. While funding concerns would remain, they would be somewhat mitigated if the “existing rails” could be enhanced.

EFTA recommends the Banks also complete an assessment of possible changes to current laws and regulations governing payments. These may include:

- The Electronic Fund Transfer Act (Regulation E)
- Truth in Lending Act (Regulation Z)
- Check Collection and Funds Transfer Act (Regulation J)
- Expedited Funds Availability Act (Regulation CC)
- State “good funds” laws
- Uniform Commercial Code Article 4A
- National Automated Clearing House Association (NACHA) Operating Rules.

Are changes to existing laws and regulations necessary in order to achieve near real-time payments? The Dodd-Frank Act transferred authority over many consumer financial laws to the Consumer Financial Protection Bureau (CFPB), including the EFT and Truth in Lending Acts. EFTA recommends the Banks work closely with the CFPB as well as industry stakeholders in the coming years to assess the impact of these laws on the ability to implement and effect near real-time payments.

The Public Consultation Paper raised the issue of whether a new, centralized directory of account and routing numbers would be necessary in order to achieve near real-time payments. In our survey, 60 percent of members supported the concept of a centralized directory of account information. With that in mind, EFTA believes such a database must be built with the highest security standards in existence today. These standards and safeguards would need to be continually reviewed and updated.

Many cyber security professionals agree two types of databases exist: those that *have* been compromised and those that *will* be. EFTA recommends the Banks consider a “meta-directory” approach versus a “mega-directory” approach. A meta-directory approach allows for data flows among two or more databases in order to achieve synchronization and continuity of data.

With regard to fraud, EFTA members are concerned that near real-time payments may present new fraud concerns. EFTA recommends the Banks assess the fraud rates in countries where near real-time payment systems exist. In the EMV space, chip-based cards in Europe and elsewhere, fraud has been reduced at ATMs and point-of-sale terminals but there have been dramatic increases in other types of fraud, such as with card-not-present transactions. It would be beneficial to learn more about how fraud has been impacted in countries that have aggressively adopted near real-time payments.

Conclusion

EFTA has a long and fruitful history of working with the Federal Reserve System on a variety of payments issues. It was in this spirit that we surveyed EFTA members on this innovative concept from the Banks.

- EFTA supports the goal of near real-time payments, but suggests that greater clarity is needed on how the term is defined
 - Once this clarification has been made, how would the Banks determine the success of this effort?

EFTA believes:

- Real-time payments will be best achieved by an innovative industry motivated by consumer demand, in partnership with the Banks functioning as one of the thought leaders behind the project.
- Any near real-time payment system must incorporate consumer protections, security, fraud prevention and a consistent regulatory structure as core principles.