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Industry Segment: Financial Institution

General

1. Are you in general agreement with the payment system gaps and opportunities identified in the "Payment System Improvement Public Consultation Paper"? Please explain, if desired.

Yes.

1i. What other gaps or opportunities not mentioned in the paper could be addressed to make improvements to the U.S. payment system?

The opportunities were identified in the document. Near-real-time transactions within the U.S payment systems need to be improved upon.

2. Are you in general agreement with the desired outcomes for payment system improvements over the next 10 years? Please explain, if desired.

Yes.

2i. What other outcomes should be pursued?

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

More check settlement cycles. Same day ACH. Less regulatory scrutiny on wire processing under a transaction cap.

Ubiquitous near-real-time payments

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.

4i. Which of these perspectives is more accurate, and why?

Coordination by a public authority or industry group. For example, large FI's struck down same day settlement for ACH transactions. My assumption is it was due to them controlling a large portion of the ACH payment industry and it gave them a competitive advantage to settle with other large FI's.

4ii. What other perspective(s) should be considered?

Fraud continues to be the main concern of banks. Near-real-time increases the opportunity for accounts to be drained. Less time is given for banks to run transactions through fraud cues to detect possible account takeover.

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

5i. Do you agree that these are important features of a U.S. near real-time system? Please explain, if desired.

Yes. There continues to be the concern in the event of account takeover, fraud losses would increase. Consumer payments are governed by Reg. E in the US where in other parts of the world there is not the regulatory restriction.

5ii. What other characteristics or features are important for a U.S. near real-time system?

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.

6i. 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?

ACH and POS are two payment systems which are already in place which could be modified to enhance the near-real-time goal.

6ii. 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?

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NACHA would have to approve same day settlement with the Federal Reserve adding more settlement cycles.

6iii. 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?

To mitigate systemic risk within the banking system, settlement should take place in near-real time. (i.e. daylight overdraft.)

6iv. Which payment scenarios are most and least suitable for near real-time payments? (B2B, P2P, P2B, POS, etc.)

ACH and POS are best suited scenarios.

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?

Speeding up electronic check return information would help. However, under check law the 24 hour return rule is used effectively today to mitigate check fraud.

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

FI's would have to reassess fraud prevention systems. There is a concern that making decisions on possible fraud in an expedited fashion could lead to more "false positives" which could negatively affect the customer base.

8i. Will near-real-time payments create new fraud risks? If yes, please elaborate on those risks.

Yes. In today's fraud arena, technology assists FI's in detecting possible fraud. If transactions are coming in near-real-time (instead of batch processing), decisions will have to be made more rapidly. The concern exists that more "false positives" will occur.

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

Mobile payments would be the prevalent choice of the consumer and most small businesses. Fraud detection in new forms would need to be addressed to mitigate losses.

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

The concern continues to be that payments would continue to grow outside the established FI payment systems. The only event that would reverse this is if there were major fraud losses in the external payment systems as they are not regulated as closely as FI's.

10i. What is the cost, including the opportunity cost, of not implementing faster payments in the United States?

TBD.

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

Core processing and backend systems today can handle multiple files throughout the day. The only concern continues to be fraud system modifications.

11i. What is the likely timeframe for any such modernization?

TBD.

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.

12i. What are the merits and drawbacks of this suggestion?

There is merit to this suggestion. Large and small FI's would be on a level playing field.

12ii. What is the feasibility of this suggestion?

If the FRB controlled the centralized directory, it would be feasible.

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.

13i. 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.

No. Check laws are currently written with a 24 our return rule which assists banks in fraud mitigation. Check 21 has already given the industry lift with next day availability.

13ii. 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." If Yes, what is the appropriate target lever and date?

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.

14i. To what extent are these efforts resulting in migration from checks to other payment types?

Lack of comfort with electronic payments by the consumer to a degree is uncontrollable by FI's.

14ii. What other barriers need to be addressed to accelerate migration of these payments?

With ACH CCD's, an FI cannot return a transaction after 24 hours and the business must deal with the unauthorized transaction. In the check world, the bank is liable after 24 hours. Thus, businesses are better protected under check law.

14iii. What other tactics, including incentives, will effectively persuade businesses and consumers to migrate to electronic payments?

Pricing of check processing to the customer higher than electronic transactions. However, this would need to be a whole industry shift.

14iv. Which industry bodies should be responsible for developing and/or implementing these tactics?

FI's.

Cross-border Payments

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?

N/A

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?

Regulatory issues on FI's make cross border payments more difficult, costly, and less timely. (i.e. the new Remittance Rule which took effect on October 28, 2013.)

Safety

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.

17i. Among the issues listed above, or others, what are the key threats to payment system security today and in the future?

Account takeover via the internet, and merchant and processor breaches within the card industry continue to be the hottest issues in mitigating fraud losses. These issues will be more prevalent as payment systems move to near-real-time.

17ii. Which of these threats are not adequately being addressed?

Losses in the card industry, POS and Signature Transactions. The customer did nothing wrong, the FI did no wrong, but a merchant was breached. Banks continue to take significant losses with these transactions.

17iii. What operational or technology changes could be implemented to further mitigate cyber threats?

Fraud systems continue to be developed and modified to mitigate this risk. However, FI's continue to be concerned with false positives which effect the customer.

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

When fraud is discovered within FI's, there's a legal concern of sharing information due to liability issues.

18i. How should this information be made available?

TBD.

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

TBD.

19i. What are the obstacles to the adoption of security-related payment standards?

Costs to smaller FI's are an issue.

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 FRB in looking at gaps and opportunities in payment improvement such as this study is the best approach.

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