December 13, 2013

Re: Walmart Response to Federal Reserve Payment System Improvement Public Consultation Paper

With annual sales approaching $500 billion, retail locations in more than 25 worldwide markets, and more than 4,000 locations in the United States – including both Walmart retail stores and Sam's Club wholesale club locations – Walmart is the world's largest retailer. In the United States, Walmart is by far the largest retail acceptance location for all major consumer tenders. Because of this scale and breadth, Walmart is uniquely positioned to provide insights into the perspective of payments systems end users.

Walmart would like to start by thanking the Federal Reserve for engaging the payments industry in this important initiative. We look forward to working along with the Federal Reserve to bring about much needed improvements in the U.S. payments system.

As you will see below, this response addresses in some depth many of the points made in the Consultation Paper. However, we will initially address four broad themes below that are, in our minds, most important as the industry begins to assess itself and the changes that are needed going forward.

1. **Cross-functional Industry Involvement:** Any endeavor to bring about wholesale changes in payments must include a broad cross-section of stakeholders. This includes merchants, consumer advocacy groups, payments networks, payments processors, and financial institutions. For decades, the various payments systems have been owned, operated, and governed by financial institutions with limited input from other stakeholders (including) merchants and consumers. It is Walmart's belief that this consolidation of interest has resulted in inefficient, fraud-prone systems that are supported by inflated fees.

2. **Governmental Oversight:** In our view it is highly unlikely that the private sector, if left to its own devices, will devise a balanced, consumer-friendly payments system. The entrenched interests in payments, particularly in card-based point-of-sale payments, have profited from the status quo for decades. Absent involvement from a governmental entity, such as the Federal Reserve, Walmart doubts that consumer-friendly solutions, like the ones outlined in the Consultation Paper are likely to come to pass. In our view, the role of this governmental oversight body should be to facilitate the creation of and the enforcement of open standards that foster competition and transparency in the marketplace. Essentially, we see the role of government to be that of operating and establishing open standards to ensure equal access to the payments processing infrastructure, fostering fair and balanced competition among large incumbents as well as emerging competitors.

3. **Fostering Competition:** Any approach to bringing a ubiquitous, real-time payments system to the market – whether by upgrading an existing system or building a wholly new system – should take into consideration the need to foster competition in payments. Today, the market for consumer card payments is dominated by two networks that have nearly 100% of the market for debit cards and more than 75% of the market for credit cards. Any solution that relies on the private sector to provide processing and networking capabilities should consider this dynamic as timelines are established. Shorter timelines tend to favor market leaders, as new entrants or smaller participants in the industry will require more time than large, entrenched participants to develop the necessary platforms and infrastructure. This approach should leverage operational expertise of the regional Federal Reserve Banks as incubators of a number of collaborative cross-functional groups that can generate policy proposals.

4. **Incremental Improvements:** Walmart believes the Federal should adopt an iterative approach. While many in the industry will position this as an "either-or" proposition, it likely is not so well delineated. For example, Walmart believes that the best long-term solution to developing ubiquitous, near-real-time payments would be to start with a new payments system model. Rather than attempting to graft these enhancements onto decades-old legacy payment platforms, the best parts of existing platforms ought to be used to develop the ideal solution. That said, such an endeavor is likely to take many years to accomplish. In the interim, it will make sense to evaluate existing platforms, such as the ACH system to determine the extent to which that platform can be enhanced to provide immediate societal benefits.

   Walmart is encouraged by these initial steps to engage the payments industry in a dialogue regarding its strategic direction. We are eager to participate in the process and lend the expertise we have to effect major changes and improvements in the payments system.

Attached to this letter are in-depth responses to select questions posed in the Payment System Improvement Discussion Paper. Should you have any question, or desire to discuss Walmart's perspective please do not hesitate to contact either Reed Luhtanen or me.

Sincerely,

Michael A. Cook
Senior Vice President and Assistant Treasurer
Wal-Mart Stores, Inc.

cc:
Reed Luhtanen
Senior Director Payments Strategy
Wal-Mart Stores, Inc.

1. Gaps

The Consultation Paper identifies a number of gaps within the existing payments system. Walmart generally agrees with all of the gaps identified by the Federal Reserve.

Troubleshoot

1. Check writing persists because checks have important attributes, including ubiquity and convenience, which are not well replicated by electronic alternatives for some transactions. Many receivers of checks prefer other forms of payment but exercise little control over the sender to request a preferred form of payment.

While it is possible other receivers of checks would prefer alternative forms of payment, Walmart generally prefers checks over more costly electronic tenders. That said, Walmart sympathizes with receivers of payments who have little influence over the sender. This same issue exists for merchants at the point of sale. For decades, the card networks have prevented merchants from effectively steering customers to lower cost, more efficient tenders.

2. In a world where several other countries are moving to ubiquitous near-real-time retail payment systems, the U.S. payment system does not have this capability. The U.S. payment system has begun to migrate incrementally toward faster payments primarily through private-sector innovation; but these innovations, when considered in total, have not resulted in a ubiquitous near-real-time system.

The misplaced incentives that permeate the U.S. payments system have impeded the development of near-real-time payments systems. Banks and networks profit considerably from an ongoing adherence to antiquated dual message transactions that slow the flow of payments. They do this because the entrenched interests have attained sufficient market power in this space to extract supracompetitive fees from merchants for the benefit of these networks and their issuing financial institutions.

4. Some features that are desired increasingly by end users are generally lacking in many legacy payment systems, such as –

- *A real-time validation process assuring the payee that the payer's account exists and it has enough funds or available credit to cover the payment;*
- *Assurance that a payment will not be returned or reversed;*
- *Timely notification to the payer and payee that the payment has been made;*
- *Near-real-time posting / availability of funds to both the payer's and payee's accounts; and*
- *Masked account details, eliminating the need for end users to disclose bank account information to each other.*
- *Payment cards and wire transfers possess some, but not all of these features; check and ACH payments generally lack these features.*

Merchants like Walmart desire efficient, low-cost payments. Existing payment cards lack efficiency and are extremely expensive. Often the so-called "payment guarantee" is used to justify these high costs. However, merchants have no such guarantee, as banks retain the right to charge transactions back for countless reasons, many of which the merchant literally can do nothing to prevent. Today's payment card systems also lack anything approaching real-time settlement. While payments to large merchants are fast, generally within a few days, credits to accountholders and payments to small merchants often take far longer. Some small merchants are wait weeks before their transactions settle. Speeding settlement timeframes would go a long way to improving cash flows and liquidity for main street businesses.

6. Mobile devices have potential to transform wide ranging aspects of business and commerce, including the payment. Digital wallet applications on mobile devices provide merchants with valuable information that can be leveraged for commercial purposes such as consumer-specific location information, transaction history, and other context-specific data. With some digital wallet applications, the payment instrument is selected during the initial set-up phase and the payment takes place in the background thereafter, reducing the visibility and choice of payment instrument at the point of sale. Payment service providers are seeking to define their service offerings in this new world.

While Walmart generally agrees with this, merchants are increasingly troubled by the potential for smartphones to allow new players to insert themselves into the data stream and disintermediate the merchant-customer relationship. The smartphone provides the means to communicate directly with customers. Walmart believes that the trusting relationship merchants have built with our customers over time should not be undermined when payments move to mobile devices.

7. Businesses (especially large ones) have payment and accounting systems that are complex and costly to change, making it difficult to achieve automated, straight-through processing of invoices, payments, and remittance information.

The fact that something is difficult does not mean it is not worthwhile. Given the state of the payments system in the United States today, significant investment is warranted to improve processes, enhance efficiency, and lower costs for all stakeholders. We cannot afford to simply continue to use an archaic, outdated payments system that is bereft with misplaced incentives protecting certain stakeholders at the expense of consumers and merchants.

8. Consumer fears about payment security sometimes inhibit adoption of electronic payments.

Agree. The existing system does very little to prevent fraud while actively eschewing fraud-preventing technology like the use of personal identification numbers, dynamic encryption, and tokenization of account credentials. Given consumers' experiences with the existing, defective product, it is likely that they will be skeptical of any advances in technology for fear these changes will simply expose them to even more fraudulent activity and hassles. This does not mean that the industry should not move forward. Instead, the industry must advance security standards to ensure data are protected and consumers' funds are secure and educate consumers about the enhanced security and speed afforded by the new platform.

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

Walmart strongly urges the Federal Reserve to take a leadership role, in conjunction with other relevant consumer-protection and financial regulatory agencies, including the operation of an efficient, balanced payment system. Additionally, all payments systems should operate on a common standard, defined by a cross-section of stakeholders all having equal voice. This stakeholder governance should include consumer protection groups, governmental agencies, financial institutions, merchants, payments processors, networks, hardware manufacturers, and others who can provide valuable input. In today's marketplace, certain for-profit entities wield far too much authority to dictate the terms for participation at the expense of other stakeholders. If the payments system is to truly move forward, a cross-section of stakeholders must have an opportunity to jointly develop the solution.

2. Desired Outcomes

Walmart also generally agrees with the Federal Reserve's enumerated "Desired Outcomes." Below is a more specific discussion of certain items within the list.

Desired outcome 1: Key improvements for the future state of the payment system have been collectively identified and embraced by payment participants, and material progress has been made in implementing them.

Agree. Merchants, who are far and away the leaders in terms of the number of payment transactions accepted, must be included in the identification and execution of any project that aims to shape the future of payments. The existing system was designed and built by banks and their networks in such a way as to maximize returns for those stakeholders. The result has been billions in costs for consumers and merchants.

Desired outcome 2: A ubiquitous electronic solution(s) for making retail payments exists that does not require the sender to know the bank account number of the recipient. Confirmation of good funds will be made at the initiation of the payment. The sender and receiver will receive timely notification that the payment has been made. Funds will be debited from the payer and made available in near real time to the payee.

Additionally, Walmart believes that this solution must preserve the merchant-customer relationship. For centuries, commercial retail transactions have occurred on a "need to know" basis, with only the parties who needed the information regarding consumer purchases having access. For the vast majority of transactions, this means that the merchant and consumer are the only parties who know what is being purchased. Advancements in payments threaten this relationship and the underlying privacy benefits of limiting access to personal information.

Desired outcome 3: Over the long run, greater electronification and process improvements have reduced the average end-to-end (societal) costs of payment transactions and resulted in innovative payment services that deliver improved value to consumers, businesses, and governments.

In the current system, electronification has actually *increased* the end-to-end costs of card-based payment transactions. The value for card networks and issuers is extremely high, as they collect supracompetitive fees from merchants. A goal of a new payments system ought to be a rational distribution of the costs that ensures all stakeholders are treated fairly.

This requires a complete re-evaluation of the entire system – both the technical operations and the business ramifications. As the industry and the applicable government actors conduct this evaluation, we must be careful not to set the existing paradigm as the baseline and assume that the results should be compared to this existing practice. A project that seeks to improve the payments system should ignore the economics of retail payments as they exist today and seek to balance the ecosystem in a way that results in equitable treatment for all stakeholders.

Desired outcome 5: The Federal Reserve Banks have collaborated, as appropriate, with the industry to promote the security of the payment system from end-to-end amid a rapidly evolving technology and threat environment. In addition, public confidence in the security of Federal Reserve financial services has remained high.

In doing so, the Federal Reserve Banks must take a measured, even-handed approach. Oftentimes, certain stakeholders' (typically networks and banks) views are given greater weight based on the perception that these organizations have more expertise in this area. An even-handed approach would recognize the fact that, while the networks and issuers have operated payment systems for decades they have done very little to secure the system. Rather than embracing simple, effective technology like tokenization and the use of PINs to secure transactions, networks and banks have encouraged their customers to use signature as a means of transaction authentication while forcing merchants to bear the costs of fraud. Ultimately, as long as fraud pervades the system, consumers are ultimately paying for that fraud in the form of higher prices.

A balanced approach should, at a minimum, include relevant regulators, merchants, consumer groups, payment processors, banks, and networks.

3. Other Questions

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?

There is no question that implementation of an efficient, equitable near-real-time payments system will require the coordinated action of a public authority. The existing network and financial institutions have no incentive to develop a system that balances financial benefits. For decades they have operated a system that rewarded their interests while costing consumers and merchants billions of dollars each year. Further, the current payment systems have been capable of implementing near-real-time payments for decades, but have not done so. The existing, inefficient infrastructure is far too lucrative for these entrenched interests to abandon, absent the action of a public authority.

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? Please explain, if desired.

Agreed. An important factor to consider regarding item (e) is that, in the case of a credit back to the consumer, the consumer should be treated as the payee. In today's payment systems, particularly the dual message systems, crediting funds back to customers takes far longer than debiting funds from a consumer's account. This causes customer service issues for merchants, which have already released the funds to the network, but which are naturally the stakeholder that receives customer inquiries regarding the status of the credit.

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

In addition to the sender not needing to know the recipient's account number, the recipient should not need to know the sender's account number. The existing payment systems used in retail environments require the exposure, transmission, and storage of sensitive account credentials. Any new system should replace the use of sensitive credentials with tokens and other one-time-use account access mechanisms. This will greatly reduce the ability of would-be thieves from compromising accounts and significantly reduce the need to encrypt data throughout the payment system.

A new system also ought to include a streamlined dispute process to ensure the recipient is able to rely upon the confirmation of good funds as a guarantee of payment. While it is likely infeasible to completely eliminate chargebacks, existing EFT (PIN debit) networks have leveraged true cardholder authentication to eliminate nearly all chargebacks, making these systems far more efficient than others in use today.

Additionally, it would be preferable for the system to support a single end-to-end transaction message specification. This would greatly enhance efficiency by reducing the need for payments system intermediaries to translate messages to different specification. Further, it would allow participants to insert themselves into the system at any point, reducing traffic flowing through the network and eliminating points of failure. This would ultimately benefit consumers as a smaller number of transactions would fail at the point of sale.

Finally, any approach must take consumers into account. In order for consumers to take advantage of a real-time payments system, consumers must be educated about the system's benefits and how it represents an improvement upon the payment platforms they are using today.

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.*
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.*

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?

Walmart urges the Federal Reserve to take an iterative approach to this question. While we sympathize with concerns that implementing an entirely new payment system is a long-term endeavor, we ultimately believe doing so is necessary. That said, there are very real, incremental improvements that could be made in the short-term to the ACH system to create societal benefits immediately. This includes speeding the time-frame for settlement to same-day, adding a response message that would indicate the presence of good funds in the account, and streamlining the dispute process to allow for greater certainty in payment.

ii. 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?

Options (a), (b), and (d) seem attractive at first, but present real risks. In each of those cases, stakeholders operating the particular systems – wire transfers, limited-participation networks, and debit networks – are enjoying certain levels of profit which they would seek to perpetuate. In order for a new payment system to succeed, the financial incentives must be balanced such that all stakeholders are incentivized to improve its efficiency and reduce costs. For that reason, modifying the ACH network seems like a good solution. However, the work needed to retrofit near-real-time payments and tokenization onto the existing infrastructure would likely be more complicated, more costly, and less effective than simply developing a new system.

Existing payment platforms have advantages and disadvantages. At this juncture, Walmart is not prepared to offer an opinion on the best tactics to create a near-real-time payments system. Until the relevant stakeholders have taken the time to review in-depth the capabilities and shortcomings of all platforms the correct course of action cannot truly be known. It is likely that key components of existing platforms can be leveraged to deliver the final product. However, it is also likely that new attributes and platforms must also be developed to fully implement the desired system.

Rather than focusing on the tactics, Walmart urges the Federal Reserve to focus on the goals, guiding principles, and governance in order to ensure that the appropriate structures are in place to build and support a balanced payments system.

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?

Near-real time funds availability and interbank settlement is an important component of an enhanced payment system, though not necessarily critical. Given the availability of telecommunications and processing infrastructure, the ability to settle funds in near-real time has existed for some time. This near-real time settlement is not deployed in the market place simply because it is advantageous for the payer, generally in the case of point-of-sale transactions the card-issuing bank, to hold onto the funds as long as possible. Because the payers designed the system and write all its rules, they have enjoyed this advantage for some time. Near-real time processing and settlement would eliminate considerable inefficiencies that persist today. Notably, customers are frequently confused at the inaccurate balances reflected in online and mobile banking applications. This confusion can often lead to inadvertent overdrafts for customers and unnecessary inquiries to merchants. Further, when funds are credited back to customers, it can take several days before those funds are made available in the customer's account. This is despite the fact that the merchant typically settles those funds back to the network the day after the transaction occurs.

When considering near-real-time payments, though, it is important for the Federal Reserve to distinguish among different types of payments in the marketplace. Merchants like Walmart would be pleased with a batch-type settlement wherein funds are remitted at predetermined times throughout the day, provided such funds are truly guaranteed upon authorization of the transaction in real-time. However, other payments (for example, payroll funds, bill payments, and other consumer-oriented payments) lend themselves to truly real or near-real-time funds availability.

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. Which of these perspectives do you agree with, and why? Although we support the near-real-time payments which is a longer term effort, there is great benefit to invest in shorter term efforts such as EPOs and Business Check Conversion that have immediate benefit. EPOs resolve many business issues while improving processing efficiency and accelerating funds availability. We recommend investing in short term enhancements to the current system to realize benefit now while also allocating resources toward the longer term solution of near-real-time payments.

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.) Yes. Check volume has decreased year over year however, migration from checks to electronic must remain a priority. Tackling the barriers for business check migration either to ACH, EDI or Card Based solutions remain a challenge. Financial industry barriers along with sluggish business/corporate customer adoption to electronic solutions must be addressed for accelerated migration to be successful. For consumers, when float is completely removed from checks, acceleration will occur naturally.

ii. Please explain, if desired.

iii. 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." Yes. Establishing a target provides a measurable goal of success.

iv. What is the appropriate target level and dat Many factors need to be taken into consideration when establishing a realistic goal realizing that the barriers are different depending on the type of payment. Business to consumer payments should have a target and consumer to business or consumer should have a separate target. The date should provide appropriate time to understand, assess and implement a change.

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? As technology advances and is less cost prohibitive for small businesses, coupled with education, migration will occur. We are very interested in reviewing the results and impact of the efforts when available.

ii. What other barriers need to be addressed to accelerate migration of these payments? Age old payment regulations sufficiently outlined liabilities and warranties for historical payments types and systems. The OCC, REG CC and FFIEC regulations to name a few need to be nimble enough to embrace developing payment types and systems while ensuring that all liabilities and warranties are sufficient.

iii. What other tactics, including incentives, will effectively persuade businesses and consumers to migrate to electronic payments? Research has been conducted to understand the reasons businesses and consumers have resisted migrating to electronic payments. Based on these findings, a tactic of targeting migration sub groups and addressing their concerns coupled with education, led by the regional banks, including real success stories to demonstrate benefits would be impactful.

iv. Which industry bodies should be responsible for developing and/or implementing these tactics? NACHA , the Federal Reserve and OCC should be involved in these tactics, with input from financial institution, merchants, consumer groups, and service providers to influence and educate. Establishing a mandated timeframe allowing stakeholders enough time comply is desirable.