

To whom it may concern,

MagTek, Inc., is pleased to comment on the Payment System Improvement – Public Consultation Paper promulgated by the Federal Reserve. We applaud the Fed's efforts to improve the payment system, and we recognize the important role the Fed plays every day in that system.

As a leading manufacturer of magnetic card swipe, check reading, and fraud prevention technology, we are keenly interested in this topic, and have internally considered the many ramifications posed by the paper over our company's 40 year history.

The following is our prepared remarks on the paper:

"In terms of goals for the payment system, be careful of "one size fits all". For instance, there are benefits in some cases to payments NOT settling in real time. Or, alternatively, that payments may be ordered such that settlement is purposefully delayed, by either the sender (post dated check) or the receiver (delayed shipment). Differentiate, perhaps, the "real time" nature of the clearing/settling from the flexibility of payment ordering.

In reference to the Fed's prior roles in the payment system, it is clear the Fed has been an important regulatory entity for card-based payments and the ACH. Reg E and Z provide protections that have allowed consumers to use these payment methods without fear of loss, therefore greatly expanding their scope and volume. It can be argued that Internet ecommerce was made possible by the assumption cardholders have always had that their issuing institutions would step in to protect them in cases of fraud and error (both payment and merchant). While consumers don't know Reg E or Z from a loaf of bread, they DO know the protections they afford.

In regards to reach and access, we agree these are key to the relevance of a payment method. It is clear that the ACH has had great success primarily for this reason. The question is, what are the elements that define reach and access? In the case of the ACH, great interconnectivity has been achieved through the use of a broadly collective standard (The ABA routing transit number, for instance), and strong deference by the primary organizing entity (NACHA) to the key stakeholders of the system, namely DFIs. Unfortunately, at the moment the ACH does not provide many of the features called for in the paper, nor do recent decisions on the part of NACHA indicate that it will any time soon.

However, card-based systems do have many of these features. Unfortunately, there is no strong deference to the key stakeholders of this system by its organizing entities, namely the card brands. While issuing banks may have had an important say when these entities were formed and developed, even they have little influence over them now. There are many consequences to this, but an important one is the near unilateral control placed over the structure of and access to the

system. The brands manage card-based payments to their own ends, which, as profit-based organizations include drawing economic rents from its stakeholders. These rents are made possible by the system's closed nature.

This effect can be seen in practice with the attempted promulgation of EMV in the US. EMV, a closed-standard developed by MasterCard and Visa, has been promoted by these companies as an improvement in security of the card-based payment system. However, the cost of the deployment of this technology (>\$10B system-wide) as well as the weak benefits predicted (card present fraud currently runs about 5bps on dollar volume) has created resistance among the stakeholders to adopt it. So much so, in fact, that MasterCard and Visa are using their control of the system to MANDATE adoption of EMV. Since a positive ROI has not been offered as a motivation for the mandate, one must conclude that MasterCard and Visa's intention for EMV is simply the reinforcement of their control over the system.

Therefore, for the purpose of this paper, one must ask whether an open, forum-based approach (that is, a true industry collaborative effort) to improving the payment system can succeed when an infrastructure that contains many of the features sought by the forum cannot be influenced by the forum. We, as an industry, have seen that these entities respond only to litigation and unilateral rule-making on the part of government. These are poor methods for achieving long-lasting improvements."

Thank you again for soliciting industry comments on your paper, and we look forward to participating with the Fed in achieving many of the goals outlined here.

Roger Applewhite  
Vice President, Strategic Initiatives, MagTek, Inc.  
Chief Operating Officer, Magensa LLC