J.P.Morgan

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Federal Reserve Financial Services
FedPaymentsImprovement.org

Dear Ladies and Gentlemen:

Thank you for the opportunity to provide comments on the Federal Reserve Banks' "Payment System Improvement Public Consultation Paper" (the "Paper"). JPMorgan Chase ("JPMC") agrees with your assessment that new technology and evolving end-user expectations are driving important changes in the U.S. payment system. We think the Federal Reserve is uniquely positioned to bring together key participants in the U.S payments industry, solicit input, and help shape the dialogue that will lead to long term improvements to the payments infrastructure and the services which the industry provides to the end-user community. We are supportive of the Federal Reserve's proposed role to both collaborate with, and provide leadership to, the broader payments community as we work to determine the best way forward.

After a generation of a stable and functional electronic payments infrastructure, new digital technology is driving profound changes in the payments eco-system. Non-bank payment providers are increasingly becoming active participants in the payments space and end-users are receptive to many of the new payment tools. One outcome has been the development of faster payments capabilities in several global markets. The U.S. market should learn from these initiatives, assessing the new capabilities and the value they offer. This will provide an opportunity to objectively evaluate an active market to determine whether there is a need to develop similar functionality in the U.S.

The Paper identifies several legitimate gaps and opportunities which should be considered in a long-term strategic assessment of the U.S. market. JPMC believes that safety and security requirements are the primary foundation for any payment system to be sustainable, and should be addressed as the number one priority during such assessment. An ongoing industry dialogue will help establish the relative importance and priority of the additional topics on which we believe the industry should collaborate and work to develop as industry initiatives. These include:

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- Interoperability/ubiquity issues
- End-to-end efficiencies
- Digital payment opportunities
- Faster/near real-time payments requirements
- Migration from check to EFT

At the conclusion of the Paper, the Federal Reserve cites five desired outcomes for the industry to achieve over a ten year period. While we generally concur with the summary description of each outcome, we believe that the “devil is in the details”, and that industry dialogue will be critical in providing more granularity to the outcomes and the long-term strategic plans. As an example, with respect to the second outcome, JPMC agrees with the recommendation for continued development of ubiquitous near-real-time retail payment solutions that incorporate tokenization to mask account credentials. A detailed industry dialogue should consider what aspects of the transaction need to be accomplished in near-real-time (e.g., notification, credit and/or settlement), the use cases that support the demand for transactional immediacy, and an assessment of the approach that should be pursued to meet these requirements.

Each of the desired outcomes identified have different value to the industry and the end-user. We recommend that after further dialogue with the industry, detailed initiatives receiving consensus support be ranked and prioritized based on the ability to address key end-user requirements, and a determination that identified “quick hits” may be valuable in jump-starting the process. Additionally, while a ten year planning horizon is appropriate, there are a number of key elements that should begin today, especially around improving safety and soundness.

The Paper asks for input on the ways the Federal Reserve should help improve the payment system – as an operator, leader and/or catalyst. JPMC believes that the Federal Reserve will need to wear all of these hats in an industry dialogue on the future of the U.S. payment system. The Federal Reserve is uniquely positioned as the primary operator of the U.S. payments infrastructure and in its oversight role of the payments industry to provide leadership for the industry meetings and discussions. All market participants will rely on the Federal Reserve to ensure that the industry dialogue remains objective and transparent and that the outcome/next steps are built on use cases, value propositions and business case assessments.

In developing our comments to the Paper, we solicited input across JPMC and included payments subject matter experts from both our commercial and consumer businesses. Our firm’s comments and recommendations are organized around the macro level themes that were presented in the Paper.

Ubiquitous near-real-time payments

JPMC agrees with the Federal Reserve's approach to assess enhancements to the payment system through an end-user focus. This ensures that new products and innovative solutions meet user needs, and investments are made where they provide maximum value. We believe that it is also important to include a business case assessment so that the investment requirements and executional challenges are evaluated along with the benefits these solutions will provide to all stakeholders in the market. The more successful new product initiatives will strike the right balance between client benefits and the investments required to develop new services. As a way forward, the industry strategic review of ubiquitous near-real-time payment solutions should examine user needs, investments necessary to manage new risks and current market initiatives.

JPMC is very much in favor of introducing new products and features that improve customer experience. Our research and analysis of user requirements supports the premise that the current payment system, including payments made through the card, ATM and ACH channels, work well for the vast majority of transactions. Payments at the physical point of sale, from a consumer perspective, happen in real time today. Recurring payments and payments scheduled in advance of the payment due date, while not real-time, meet user requirements.

There are some use cases which would benefit from a near-real-time payment solution that the industry should pursue. Such use cases include scenarios where users require money on a time sensitive basis, and consider wire transfer to be too expensive or impractical. These scenarios and potential areas of focus by the industry include:

- Emergency consumer bill pay – when consumers pay at the last minute
- Time sensitive P2P – when the beneficiary needs the money urgently
- Time sensitive account-to-account transfers – when a consumer needs to transfer money from one account to fund a transaction in another account
- Merchants getting paid earlier by their acquirers for card transactions, increasing their liquidity
- Emergency payroll - where there was either a processing error in the original payroll, a need to accommodate weekly payroll for hourly workers, a regulatory requirement to pay someone on their last day of employment, rather than in the next pay cycle, and commission payments
- Other emergency business transactions – just-in-time supplier payments where finality is not imperative, making wires costly.

While additional near-real-time payments may be valuable to end-users, increasing the speed of payments to near-real-time will potentially increase the risk of fraud. As a result, real-time payment networks and services must be developed with an enhanced level of risk management and fraud mitigation tools. The industry will need to look at all participants in a near-real-time payment network, including banks, their clients and third parties, to identify the risks, understand who will be responsible and include management and security mechanisms to help manage such risks. The dialogue needs to include whether real-time fraud monitoring and detection can be accomplished. Our understanding is that when the UK moved to Faster Payments, many latent risk management issues were exacerbated, and the cost of establishing real-time risk management capabilities exceeded tens of millions of pounds per bank. As a result of the UK's experience, we believe that any move to a near-real-time payments network in the U.S. would require a significant overhaul of current banks' risk management systems, and could be sufficiently costly and require significant investment which many stakeholders may not be able to afford or justify.

Additionally, while we are supportive of the innovation that third party payments providers bring to the market, we believe that as this innovation increases the industry needs to ensure that the payment system remains safe, and that payments initiated by third party innovators are held to the same standards as bank-initiated payments. Implementing real time ubiquitous payments should require effective and sustainable certification, audit and compliance processes. These requirements potentially represent a significant investment by payment industry participants, and a business case assessment will be important to help prioritize this investment.

There are already some emerging innovative solutions in the market regarding alternative ways to address core real-time payment issues. These solutions include:

- Aiming to achieve ubiquity though bank partnerships
- Using e-mail addresses instead of bank account numbers to send money
- Having either a central party or bank partner manage settlement risk in order to provide consumers real-time access to funds

As the dialogue around real time payments continues, the industry should evaluate whether some combination of these models can achieve our goals, or if a new system is required. The Federal Reserve can play a valuable role in helping to achieve ubiquity by ensuring common standards while the industry continues to innovate.

A primary reason the U.S. payment system is both effective and efficient is the long history of market infrastructure operators, banks and other participants in the payment system working together to meet customer needs and improve the payment system in a safe and risk-managed way, ensuring a level playing field for all payment providers and consistent benefits and guardrails for users. In developing future innovation around faster payments, JPMC believes that this partnership will remain crucial:

- Banks will continue to evaluate innovative ideas, and play a key role in providing investment in, security of, and access to the U.S. payments system.
- The goal of achieving scale, to both drive adoption and manage costs, will require the largest service providers in the country to be actively on board and investing their resources to drive adoption.
- The Federal Reserve, as well as large technology providers, play key roles in helping to achieve ubiquity by pulling the industry together behind any potential successful solution, as well as providing services to the banks that do not have the resources to build them on their own.

JPMC is supportive of further innovation around near-real-time payments and wants to see the industry proceed with new solutions that make sense, recognizing that the industry is already at work on several such initiatives. The Federal Reserve can lead the industry dialogue on near-real-time payments innovation which have value to all stakeholders and meet the Federal Reserve's safety and soundness requirements.

The industry has long talked about a "FedEx" model, where end users pay different prices for different levels of speed, certainty and information around payments. We believe this is fundamental to the successful implementation of a real-time payments initiative, and that the use cases need to fit into this model, where users will actually be willing to pay for the increased speed they are receiving.

Electronification

Check is a long-established and widely accepted payment instrument that has ubiquitous features which users value. There are some underlying issues which need to be addressed to lower the barriers to use of electronic funds transfers (EFTs) for business-to-business payments; these include the difficulty in convincing customers and suppliers to accept electronic payments, non-standard formats for remittance information, and the shortage of IT resources. These issues have endured for years and we would welcome new initiatives that move the industry forward.

Larger corporations appear to be more successful overcoming these issues, in part because they are in a better negotiating position to convince business partners to switch to electronic payments and they have better access to resources, such as technology, to make the necessary investments to gain straight through processing efficiencies. While small businesses would certainly benefit from electronification, they are challenged by costs, compliance, gathering and storage of bank account information and scarce resources. Small businesses, especially those that write less than 10 checks a month, find checks to be an easier payment option since they are a universally accepted payment type and accepting them may be the simplest and cheapest method for receiving payment. Given the complexity of issues that business clients have in sending electronic payments, JPMC does not see significant industry interest or value in a mandated timeline to move away from B2B check payments. However, we do believe that there are market-centric ways to address customer needs around payment electronification without mandating a timeline to move away from checks.

For example, in the consumer/retail market, technology innovations that are convenient and easy to use are driving consumer behavior to adopt electronic person-to-person and bill payments for low value payments. Also, JPMC is starting to see increased usage of P2P tools like Chase Quickpay by small/micro businesses because it is cheaper and easier to send and receive than classic ACH. In order to grow this category, there is a need for increased ubiquity across financial institutions, vendors and existing infrastructures/utilities. This ubiquity combined with innovative end-user tools will continue to drive a natural decline in check writing. Federal Reserve leadership of an industry-wide effort to develop this ubiquity would be a valuable component of a strategic plan to improve the payment system in the U.S.

Cross-border payments

As ISO 20022 message standards are more broadly adopted in key global markets and by the corporate user community, there will be opportunities to develop efficiencies facilitated by the richer data content of these messages. Examples include:

- Delivery of extended remittance information across the payment chain to the end beneficiary where the use of one set of standards across all payment systems would enable a scale and consistency of operation unrealized to date
- Performance of regulatory compliance activities such as sanctions screening which would be better addressed with messaging standards with more information related to payment parties than those available today
- Achievement of a global operating model for interoperability, payment tracking and payment notification

The Federal Reserve put a stake in the ground to develop these capabilities back in 2011, and the lack of take-up is an indication of the challenges the industry faces in implementing these capabilities across global markets. A component of the roadmap for action should be Federal Reserve leadership in helping to prioritize and coordinate this global industry dialogue.

Interoperability across global clearing payment infrastructures is a valuable end-state, and will need to be managed by the industry until adoption of the ISO message standards reaches critical mass. For the U.S., this may result in a business case plan that prioritizes adoption of ISO 20022 message standards for cross-border transactions in order to facilitate interoperability with other adopting markets. In addition to addressing interoperability issues, adoption of ISO 20022 message standards in global markets provides an opportunity for the regulatory community to standardize the information requirements for AML/CTF compliance. Any coordinated global action in this area has the potential to enhance cross-border payments market efficiency.

We acknowledge, and applaud, the Federal Reserve's leadership role in the High Value Payment Systems Operator Group. This group can provide an effective forum for global market infrastructure operators and (potentially) regulators to address cross-border interoperability and AML compliance issues across payment systems.

With respect to low-value/ACH market infrastructures, it is interesting to note that there has been some encouraging success with a rules-based framework for interoperability, both with industry (e.g. IPFA and Earthport) and proprietary (e.g. JPMC's FSI service in Asia) solutions.

Safety

The U.S. payment system is undergoing a remarkable period of change, driven by rapid adoption of technology, new threats and risks posed by technology and its uptake, evolving end-user expectations, as well as heightened regulatory requirements. The future challenges payment market participants to continue pursuing innovation that improves speed, efficiency and service, while maintaining the requisite level of control and confronting and managing escalating threats.

Safety and soundness concerns should drive the timing as central issues to address while pursuing innovation. Safety and soundness principles which we expect will drive the future of the payment system development include a continued focus on and response to current and emerging issues, namely:

- Protecting customer credentials from the increased data security risks coming from digital proliferation of account information. One industry focus should be on tokenization initiatives, with industry standards that insure ubiquity. Protections need to address both the banking industry directly as well as the end-users.

- As third party payments volumes grow, common rules and regulations for all participants in the payment system (banks, non-banks and third parties) and across payment types are required, ensuring the payment system is safe and secure regardless of what type of entity is initiating or accepting transactions.
- Global cyber risks requiring global coordination to identify fraud and fraudsters operating across borders. Global engagement, coordination and development of technical and regulatory standards is required. Distributed denial of service attacks, theft of credentials and other confidential data, systems hacks and hijacks are but a few of the new types of fraud banks and other payment system participants must now confront and overcome.
- In order to ensure compliance with rules and regulations, the industry needs adequate certification processes and enforcement mechanisms across all payment methods and participants, with a focus on the risks associated with regulatory compliance, cyber security, fraud and user authentication.
- With a greater migration to electronic payments and near-real-time activities (often through mobile devices), the ability to follow and capture payments data and to derive adjacent, and sometimes personal information, is expanding, and the interest in use of this data is increasing. The industry should establish standards, protocols and privacy protections to promote fair and appropriate use of payment data beyond payments facilitation. Consumer and business adoption – particularly global adoption and the mitigation of franchise and reputation risk with these emerging technologies - will be enhanced through clear and direct limitations on data use and consistent standards across payment alternatives.

While some of these issues are being addressed today, greater industry engagement is required to prioritize all of these initiatives to ensure that the payments system has a strong foundation that will support the pace of innovation the industry anticipates. As an example, new efforts are required to:

- Foster new security and identity standards
- Ensure that rules and regulations provide adequate safety regardless of whether payments are initiated by banks or third parties
- Develop industry utilities enabling realization of security and ubiquity
- Establish more effective global information and data sharing to better coordinate security threats and identify bad actors

The Federal Reserve and the broader industry, including banks and non-bank payment providers, need to fully consider the risk issues presented by these factors, especially in relation to the desire for real-time payments. Different levels of speed and certainty of payment require different levels of security. At faster speeds, access to payment systems will need to be stronger, and fraud detection mechanisms will need to be more responsive, and happen immediately upon payment initiation. When payments are irrevocable, access to online banking needs to be virtually fraud proof.

Security of online banking services will require continual investment and improvement. Additional standards and possibly government regulation may be required to achieve a consistently strong objective in the face of ever evolving threats.

In closing, JPMC appreciates the opportunity to provide our views on the future state of the U.S. payments industry and we support the Federal Reserve's efforts to provide a valuable resource for further collaboration. We look forward to contributing to the ongoing dialogue.

Respectfully submitted,

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