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Industry Segment: Business/Merchant

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, we are in general agreement with the gaps and opportunities that have been identified.

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

Almost 30% of the U.S. population is unbanked, or under-banked. By and large, this segment of our population relies on alternatives to traditional banking services, often at a higher cost. These same people are generally the ones who can least afford these alternative services. Point #3 in the Fed's paper even specifically refers to a more ubiquitous solution for those who already maintain a transaction account with their bank. We believe it is in the public's (and our) best interest to reduce the unbanked and under-banked population in our country. If changes to the payment system can be a part of that solution, then it should be included in this process.

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

Yes, we are in general agreement with the desired outcomes.

2i. What other outcomes should be pursued?

See above comments on the unbanked.

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

We are open to any discussions which will lower our transaction costs.

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?

We believe the former perspective is more accurate. Current payment service providers often rely on proprietary technology, and usually prefer to retain that ownership, and maintain and/or improve it to maintain or increase their competitive edge and thus, market share. Put another way, competitors are unlikely to give up what they see as a competitive edge unless they are forced to. Said another way, a ubiquitous solution may require standardization, and that is acceptable, as long as it doesn't hinder innovation, nor unfairly erode an organization's competitive edge.

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

We believe that AFD devices represent a special type of payments that are unlike most others. Currently, card issuers and networks treat these as card present transactions, when for all intents and purposes, they are actually card not present transactions. Additionally, they are one of the few purchase types where the amount of the sale is not known until the practical exchange of value has occurred. As most customers still want to be able to fill ~er up ̄this presents a unique set of circumstances. We recommend that this particular class of transactions be given special consideration in the overall evaluation of the payments landscape.

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.

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

No comments at this time.

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?

We believe that there is no most effective way to deliver ubiquitous near real time payments. The payment landscape is so broad as to encompass a huge variety of needs. There is no silver bullet that will solve all of the issues, or even this one issue. Instead, a holistic approach will be required.

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?

We cannot comment on the costs and benefits, other than to say that broad industry participation in an extensive cost/benefit analysis will be required. And even then, it will likely be difficult to achieve agreement. The question of pros and cons is another matter entirely. What some may perceive as improvements in the overall payments landscape, others may not. This, absent regulations forcing participation, could minimize the effectiveness of any given set of solutions. Last, implementing faster payments within existing payment processing channels is unlikely without extensive modifications. If this were not so, faster payment solutions could already be in place.

6iia. What rule or regulation changes are needed to implement faster payments within existing payment processing channels?

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?

Near-real-time authorization is the norm today, as are confirmation that good funds are enroute (but still subject to chargeback, which is the real rub). So, the latter is correct. Do near-real time payments imply intraday settlements, including nights, weekends and holidays? Can we have near-real time

payments, but only part of the time? Engineering a 24 x 7 x 365 solution is many times more complex than our legacy systems. The costs could be enormous.

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

In our opinion, in order of descending suitability, B2B, P2B, POS, and P2P.

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?

We believe that it is not an either/or question. As the question is written, it is simply a matter of assigning the appropriate amount of manpower to achieve the desired result. The options themselves should stand or fail on their own merits.

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

As mentioned earlier, we believe that AFD transactions are a unique transaction type. Fraud is rampant in our industry, and the current proposed solutions (EMV, Chip & PIN, Chip & Choice) are so expensive as to not be cost-effective. We believe that one action the Fed should immediately consider is the prevention of the mandated liability shift related to EMV adoption, currently set for 2015 and 2017. Near-real-time payments in today's environment probably wouldn't reduce fraudulent activity. Near-real-time payments relate to the timing of the clearing of the transaction. If a credit card limit hasn't been reached, nor a bank account drained, fraud will still be possible if the card can be used.

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

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

The mobile payments landscape is extremely fractured, with over 140 mobile offerings on the market today. Conversely, the mobile phone market is highly concentrated, (but still very competitive). Mobile phone manufacturers rely on different technology for their offerings. For instance, Apple's iPhone does not contain a chip required for near-field communication technology. Said another way, mobile platform and mobile device offerings are market driven industries, with very little regulation on their technology (other than the mechanics as regulated by the FCC), and even less on their use. Regulatory bodies should be extremely careful that forced changes do not stifle innovation and competition.

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

We agree that near-real-time payments are a key building block of for innovation, particularly in mobile payments. We further agree that the Fed's recap of benefits as stated in the Desired Outcomes section of the paper is accurate. In particular, solutions to ever more sophisticated fraudulent schemes must be identified and implemented. As we stated earlier, we are not convinced that the proposed EMV solution is necessarily the best solution.

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

We believe that these costs cannot be identified without an extensive study.

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

This question, more than any other, gives us pause as to both the feasibility and advisability of the changes required to achieve the desired outcomes. We agree that core processing and back end systems will need to be modernized. But, perhaps the bigger issue is that they will need to be standardized. Entire industries have been built to support the payments landscape, both in the U.S., and around the globe. These include banking and lending, computer hardware and software manufacture, development, implementation and support, and communications to name but a few. A great many of these utilize proprietary business processes and systems that were developed using capital obtained from private investors. One could argue that those investors have a right to a return on their capital. Then there are those who would argue that the current major players in the payments space have become oligopolistic in nature. These matters have been litigated in the courts for decades, and will not likely be resolved in the foreseeable future. Others have tried to accomplish legislatively what they could not through the courts, e.g., the Durbin Amendment. And now, it appears we may attempt to drive changes through regulation. We are assuming that the Fed has the legal authority to do so. Having said all of that, we are very concerned that the level of standardization required to achieve the desired outcomes may be a very risky and expensive proposal. Who will pay for these changes? And, if the desired outcomes require standardization, and if we regulate the fees associated with the services provided, then we'd likely need to provide for a predictable return on investors' capital, much like a public utility. Further, if the costs are excessive, then it follows that the fees necessary to cover the return on capital will result in a system that is much more expensive to operate than what we have today. All of this could result in a substantial dismantling of the payments space as it exists today.

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

On July 31, 2013, Judge Richard Leon of the U.S. District Court for the District of Columbia delivered a completely unexpected ruling on the Fed's implementation of certain provisions of the Durbin Amendment, which had been in place for about ten months. Basically, he ruled on two areas, one, that the Fed had erred in its definition of operational debit card costs, that they were too broad, and thus too high, resulting in fee caps that were too high (at about \$.22 per transaction for non-exempt banks), and that the Fed did not follow the intent of the legislation when implementing rules for the

routing of debit transactions (again, for non-exempt banks). The Fed immediately appealed to the D.C. Circuit Court of Appeals. Leon immediately issued an order staying his ruling pending the appeals process. We've said all that to say this: We believe the Fed should be very mindful of how the above scenarios, (plural because there are many possibilities, none of which are certain), play out. The outcome will undoubtedly have an impact on many of the gaps and desired outcomes outlined herein. In reference, in early November of 2013, a conference of expert retailers, networks, banks, entrepreneurs, venture capitalists, lawyers, and economists met in D.C., to discuss the Durbin Mess ². The timing of the resolution of all of the issues was one of the hot topics on the agenda, for obvious reasons. Estimates as to the timing of full resolution of the various issues range from as early as 2015 to as late as 2020. Much of this time span of uncertainty occurs simultaneously with the work that would have to be done now, if the Fed's desired outcomes were to be achieved within the stated goal of ten years. It is interesting, perhaps somewhat ironic, that the Fed is soliciting this feedback, while simultaneously is an active participant in the litigation mentioned above. But again, the question relates to timing, and to that we say, whatever you do, proceed with caution.

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?

No comment. Not enough information regarding the structure and mechanics of such a solution is provided to answer the questions.

12ii. What is the feasibility of this suggestion?

No comment. Not enough information regarding the structure and mechanics of such a solution is provided to answer the questions.

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.

: The answer depends upon the cost of a forced solution ² For instance, my local liquor store is a successful small business, and as a necessity for keeping her customers happy, accepts Visa and MasterCard. Her local merchant bank who acts as her processor is legally charging (gouging) a fee of over 6%. She would much rather just take checks and walk across the street to the bank and deposit them every day. So, in this case, and millions like it, moving from checks to electronic payments doesn't benefit the public.

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?

Yes. See 13(i) Response above

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?

We would refer the Fed back to their own data, as presented in The 2010 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2006 “ 2009. Updated April 5, 2011, prepared by a committee of various employees of the Fed, working in conjunction with a team of consultants from McKinsey & Company. Preliminary results for this triennial report for the period 2010-2013 are slated to become available in late 2013, with a final detailed report expected by mid-2014. The Fed could refer to the 2001, 2004, and 2007 reports should it wish to examine a lengthier trend line. As stated in the Executive Summary, the increase in electronic payments and the decrease in checks can be attributed to technological and financial innovations that influenced the payment instrument choices of consumers and businesses, among other factors.

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

We believe that a primary barrier to migration towards electronic payments is the cost of accepting those payments. As mentioned above, small businesses pay exorbitant interchange fees. A contributing factor could also be a lack of education. For instance, small businesses or consumers may be uncomfortable with electronic payments, simply because they don't understand them.

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

On the topic of incentives, whom would the Fed recommend pay for these incentives? As to who should be responsible for implementing these tactics, perhaps those that are paying for it should have a say in the matter.

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

See 14(iii) Response above

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 electronification of business payments and/or cross-border payments?

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?

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?

We believe that the issues listed make the major concerns as they exist today. In the future, who knows? We may indeed convert to an EMV solution some day, but someone will always be trying to beat the system.

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

Mobile seems to be the obvious answer. There are over 140 mobile software solutions currently on the market that work on a variety of mobile devices. It is our understanding that this space is not subject to much, if any, regulation or oversight. Another area that seems to be wide open is residential wireless networks, which are exceptionally vulnerable to hacking.

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

EMV is highly touted as a solution, but it should be noted that EMV has been operational in Europe for several years, but as recently as 2011 saw an increase in pay-at-the-pump fraud. The problem lies in the fact that many EMV cards still have a magnetic strip, and as long as there is a mag strip, there is the potential for skimming devices to pull card data. If we're going to do EMV, we should only do Chip & PIN, not Chip & Choice, and we should do away with the mag strips altogether. Unfortunately, the only practical way to make this happen is through a near 100%, near simultaneous conversion, an extremely unlikely event. Sometimes the best solution is the simplest solution, and in this case, we believe it is PIN based debit and credit. Fraud perpetrated against PIN based transactions is a very small percentage when compared to credit and signature debit. While we are waiting on EMV or some other magic bullet, why shouldn't all transactions require a PIN number? Yes, there is a cost associated with this, but it likely dwarfs that required to implement EMV. This should be studied as a bridge solution.

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

A credit fraud Amber Alert system could possibly be used in severe situations, along with recommended action.

system could possibly

18i. How should this information be made available?

It could be distributed through a national email contact list that interested parties could opt into.

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

See above comments on EMV and PIN.

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

Obviously, cost is an issue. The technical skills are probably not there within the small business community. One of the biggest obstacles we are currently hearing is the lack of trained certification personnel. For instance, if everyone in the U.S. were financially and technically capable of implementing EMV at this very moment, there simply aren't enough qualified firms available to complete the required certification process between now and the required EMV implementation dates as currently defined. Further, the certification standards aren't even complete.

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?

Conversations such as this are a good start. If we're going to get serious about security, then a collaborative process is essential. For example, card associations and issuers stand in a vacuum and swing the EMV mandate like a club, when the obvious costs of the solutions far outweigh the benefits. The pay at the pump mandate is openly ridiculed at industry conferences. We certainly don't have all the answers, but not working together isn't going to accomplish anything. We agree with the Fed's conclusions on collaboration and engagement.

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

As broad as these questions are, we wonder more about the questions that haven't been asked. We are talking about overhauling the mechanisms that facilitate the transfer of value for goods and services in our country. In 2008, we saw what happened when a credit crisis caused us to not be able to get the money we needed to spend. What would our world look like if we couldn't spend the money we already have? If we're really going to do this, we'd better get it right.