

Industry Action to Address Future of Payments



PHOTO: MICHAEL BATTIS

Mark L. Mullinix
First Vice President and
Chief Operating Officer

Today, the Federal Reserve's operator role in payments is significant and encompasses Reserve Banks providing payments services to depository and other institutions and serving as fiscal agents and depositories for the United States government and other entities. Broadly speaking, Fed banks distribute the nation's currency and coin; offer priced services that include transferring funds and securities, collecting checks, and operating an automated clearinghouse

(ACH) service; and provide a multilateral national settlement service.

From a public policy standpoint, in 2012 the Fed announced its desire to engage the payments industry with the aim of improving the speed, efficiency, safety, and accessibility of the U.S. payment system from "end-to-end." This new focus marked a notable shift in approach as Reserve Banks had previously focused primarily on interbank payments activity.

Increasingly, consumers and businesses have expressed preferences for faster payments and strengthened authorization and authentication across payments methods and channels given the proliferation of threats of fraud and data breaches. Our engagement with large and small businesses, emerging payments firms, card networks, payment processors, consumers, and financial services providers surfaced important issues and led to the public release of the Fed's 2013 "Payment System Improvement—Public Consultation Paper." The paper identified gaps to be addressed and opportunities for improving the U.S. payment system. The consultation paper also spawned

end-user research to better understand specific industry feedback regarding payment attributes such as speed and security. This work concluded in 2014 and resulted in the January 2015 release of "Strategies for Improving the U.S. Payment System," which summarizes the call to action for industry stakeholders to come together to improve the U.S. payment system.

The Fed's role in the payment system is aimed at promoting the integrity and efficiency of the payment mechanism and ensuring Reserve Banks provide services to all depository institutions equitably and in the spirit of competitive fairness. From a policy standpoint, if the Fed engages in any new, or changes any existing payment service, the following conditions must all be met: The service must achieve full cost recovery in the long run; the Fed must reasonably expect the service to yield a clear, public benefit; and the service should be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity.

The criteria outlined above were developed before many technological advances that are now in wide use. So, engagement with the industry demands that we consider applying these criteria to new ideas and in new ways. For example, when discussing identifying a fast, secure, and efficient method to improve end-to-end payments, how does the Fed ensure equitable provision to all institutions and payments end users? What was once a finite market of financial institutions has expanded significantly as nonbank payments providers now operate in the payment value chain. And, if other providers cannot or will not provide a service with reasonable effectiveness, scope, and equity, what is the appropriate policy response for the Fed?

The Fed does not take potential modifications to or changes in our payment system role lightly. Thus, when exploring new possibilities or opportunities, the

Board of Governors of the Federal Reserve System is required to conduct competitive-impact analyses to understand what, if any, direct and/or material impact the operations of the Fed would have on the ability of other service providers to engage in similar services.

The Federal Reserve has established five desired outcomes of its industry engagement to improve the U.S. payment system:

- **Speed:** A ubiquitous, safe, faster electronic solution(s) for making a broad variety of business and personal payments, supported by a flexible and cost-effective means for payment clearing and settlement groups to settle their positions rapidly and with finality.
- **Security:** U.S. payment system security that remains very strong, with public confidence that remains high, and protections and incident response that keeps pace with the rapidly evolving and expanding threat environment.
- **Efficiency:** Greater proportion of payments originated and received electronically to reduce the average end-to-end (societal) costs of payment transactions and enable innovative payment services that deliver improved value to consumers and businesses.
- **Cross-border Reach:** Better choices for U.S. consumers and businesses to send and receive convenient, cost-effective, and timely cross-border payments.
- **Collaboration:** Needed payment system improvements are collectively identified and embraced by a broad array of payment participants, with material progress in implementing them.

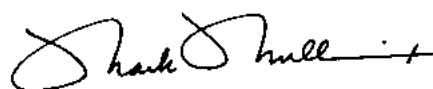
Collaboration with the financial services industry is critical to the success of any payment strategy pursued by the Federal Reserve. NACHA (The Electronic Payments Association) has also been engaged to better understand the needs of consumers in payments. NACHA is exploring gaps in the current payment system, including check writing, converting businesses to electronic payments, and moving closer to the delivery of real-time payments, among

others. Specifically, NACHA is giving its attention to the implementation of same-day settlement for ACH transactions. In October 2014, The Clearing House (TCH) and its members announced a multiyear initiative to build a real-time payment system. The work of the Federal Reserve has been informed by TCH efforts, and it is encouraging to see these and other efforts taking aim at the same objective: to improve the end-to-end speed of payments in the United States.

Implementing faster payments capabilities is no easy task and will take the collaboration and engagement of all payments industry stakeholders. As noted in the strategies paper, learning from the industry is essential to identifying potential approaches for payment system improvement that the Fed may pursue.

Efforts in 2015 will include the work of two task forces—one to focus on faster payments and the other on payment security. The industry members of these panels will assess alternative approaches for delivering faster and more secure payments.

In spite of these recent constructive efforts by industry participants and the Fed, the payments industry and environment continue to change and evolve—and so we know that this effort will not be easy. Nonetheless, the Fed remains committed to improving the U.S. payment system with industry-wide assistance through stakeholder participation in the task forces, by seeking feedback, and through the dedicated individual action of payments providers and firms. I encourage you to visit <https://fedpaymentsimprovement.org> to learn more about this effort and to stay abreast of new developments and ways to get involved.



Mark L. Mullinix

First Vice President and Chief Operating Officer