

U.S. Payment System Improvement and the Federal Reserve



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Good morning. As the central bank of the United States, the Federal Reserve has a strong interest in fostering a well-functioning payment system. In my brief time this morning, I will answer three broad questions about the collaborative initiatives being led by the Federal Reserve working with private-sector stakeholders. These initiatives are aimed at improving the U.S. payment system's speed, efficiency, access, and security. As always, the views I'll present today are my own and not necessarily those of the Federal Reserve System or my colleagues on the Federal Open Market Committee.

The first question one might ask is, "Why is there a need to improve the U.S. payment system?" There has been a lot of talk of late about the need to improve the infrastructure of the U.S. Mostly this has referred to things like highways, bridges, railroads, aviation, and water treatment, all of which play an important role in fostering economic growth and development. I think we should also consider the U.S. payment system a critical part of the infrastructure of this country. A modern payment system is not a luxury. It is a necessary part of a vibrant economy.

The current payment system in the U.S. is meeting the immediate need of moving payments from payer to payee. It is good to remember that the current system is supporting an \$18 trillion economy. In 2012, over 120 billion non-cash, non-wire-transfer payments, valued at almost \$175 trillion, were made in the U.S.¹ There is a long history of payment-system innovation in this country, including the move from paper check to check imaging and electronic presentment, as well as the advent of Internet and mobile banking. Nonetheless, the payments landscape has been rapidly changing over recent years, and the U.S. payment system is at a crossroads. It is a fragmented patchwork of payment vehicles and providers, often lacking interoperability with one another or the ability to combine invoice information with a payment. The complexity of the payment system, involving incumbent providers, new entrants, and end users,

¹See "[Strategies for Improving the U.S. Payment System](#)," Federal Reserve System, January 26, 2015. This paper and other information on the Federal Reserve payments improvement initiative can be found on the website FedPaymentsImprovement.org.

makes it harder to coordinate payment innovations. Thus, even as the payment system has grown in complexity, it has not kept up with the evolving expectations and demands of end-user businesses and consumers. Nor has it kept up with developments in other countries that have taken steps to modernize their payment systems.

Much of the change in the payment system landscape has been driven by the rapid evolution of technology. Higher-speed computers and mobile devices have enabled the rapid development of e-commerce, which has changed the nature of both retail and business-to-business commerce. Consumers and businesses are demanding faster payments, both domestic payments and cross-border payments. Indeed, maybe the best indication that consumers and businesses want faster payments is that they are willing to pay for speed. According to analysis commissioned by the Federal Reserve, about a third of consumers and three-quarters of businesses are willing to pay a fee for payments that offer faster availability to the payee.² In addition to meeting customer demand, a modernized payment system could have an added societal benefit of bringing the unbanked and underbanked into the financial mainstream. It could also help low-income households, small businesses, and others who need to closely manage their finances to gain faster access to their funds.

Assessing these trends, the Federal Reserve and a diverse set of industry stakeholders have come to agree that the U.S. payment system needs to evolve further and faster to support the changing nature of commerce, keep pace with the global economy, meet the changing needs of end users, and address new and ongoing threats to safety and security. An improved payment system will contribute to public confidence, economic growth, and global competitiveness.

² See [“Strategies for Improving the U.S. Payment System,”](#) p. 29; and [“Research on End-User Demand for Select Payment Attributes: Research Results Summary,”](#) March 2014.

Given that we see a need to modernize the payment system, a second question comes to mind: “What approach is the Federal Reserve taking to facilitate the move to a faster, more efficient, ubiquitous, and secure payment system?” Earlier this year, the Federal Reserve Board and Reserve Banks published a paper entitled “Strategies for Improving the U.S. Payment System.”³ This paper communicates our desired outcomes for the payment system and outlines the strategies and tactics that the Federal Reserve is pursuing, in collaboration with stakeholders, to help the country achieve these outcomes. As indicated in the “Strategies” paper, there was a lot of work that preceded the current initiative. In 2002 and in 2012, the Fed undertook gap and opportunity assessments of the payments environment, seeking and receiving considerable input from the public on where the payment system was lagging and where it could be improved.⁴ That work laid the foundation for the current initiative, which seeks to achieve five outcomes: (1) a payment system that offers a safe and faster electronic solution for making a variety of personal and business payments, which is ubiquitous and available on demand; (2) a payment system that is secure and resilient, and so one in which the public can be highly confident; (3) a payment system that is efficient and offers better value to consumers and businesses; (4) a payment system that offers a more convenient, cost-effective, and timely way to make cross-border payments; and (5) a payment system that has been improved via a collaborative process involving a broad array of payment participants.

The collaborative approach the Fed is pursuing follows on from the comprehensive stakeholder engagement we undertook in 2012 to assess the payments landscape. Most of those who commented on the consultative paper that summarized the Fed’s findings strongly supported the Fed’s continuing to serve as a convener of payment-system stakeholders and as a catalyst for collaboration.⁵ Comprehensive improvement of the system for making payments end-to-end will require a comprehensive approach

³ See “Strategies for Improving the U.S. Payment System.”

⁴ See “Payment System Improvement – Public Consultation Paper,” The Federal Reserve Banks, September 10, 2013; and “The Future of Retail Electronic Payments Systems: Industry Interviews and Analysis,” Board of Governors of the Federal Reserve System, Staff Study 175, December 2002.

⁵ See “Payment System Improvement – Public Consultation Paper.”

based on collaboration among and actions from a diverse set of payment stakeholders, including traditional and nontraditional payment providers, technology companies, the government, and end users.

I should note that the approach the Fed is taking to support and guide these various parties to work together on strategies to improve the payment system differs somewhat from the approach taken in other countries, some of which have officially mandated changes to speed the adoption of more efficient payments. For example, the Faster Payments Service launched in the United Kingdom in 2008 was implemented by the private sector by request of the government.⁶ The New Payments Platform currently being built in Australia, with expected launch date in mid-2017, was an industry-based solution proposed after the Reserve Bank of Australia, that country's central bank, undertook a strategic review of payment innovation and published strategic objectives it expected the payment system to meet.⁷ The Fed does not have the power to mandate a solution, nor could we implement meaningful payment improvement on our own. We recognize that many payment innovations have come from the industry. So the Fed is taking a leadership role as a catalyst to spur a private-sector solution that will align private-sector interests with those of the public. This is consistent with the Fed's responsibility to foster a well-functioning payment system for the public benefit. We believe our collective and collaborative approach to payment-system improvement will increase the probability of successful outcomes by encouraging ubiquitous access and widespread adoption of new payment-system capabilities. Note that the Fed's approach does not preempt or compete with other efforts already being undertaken by the industry, one of which is The Clearing House's multiyear project to build a real-time payment system for all U.S. financial institutions.⁸ And it does not mean that the Fed will halt efforts to improve the efficiency of the payment services we

⁶ See Fumiko Hayashi, "Faster Payments in the United States: How Can Private Sector Systems Achieve Public Policy Goals?" Federal Reserve Bank of Kansas City Research Working Paper no. 15-03, June 2015.

⁷ See "Strategic Review of Innovation in the Payments System: Conclusions," Reserve Bank of Australia, June 2012; and "RBA Core Criteria for a 'Fast Payments' Solution," Reserve Bank of Australia, November 2012.

⁸ See "The Clearing House to Undertake a Multi-Year Effort to Design and Develop a Secure, Real-Time Payment System," The Clearing House press release, October 22, 2014; and "Innovative Real-Time Payment System for the U.S. – VocaLink," The Clearing House press release, October 26, 2015.

ourselves are providing. In fact, we are acting to speed up settlements on our National Settlement Service, promoting greater use of same-day ACH capabilities, and considering other enhancements to our services that will have a positive impact in the near term.

This brings me to the third and final question you may be asking yourselves: “What’s been accomplished so far on the payment system improvement initiative?” I am happy to report that since the “Strategies” paper was published earlier this year, there has been considerable progress. First, we have appointed some able leaders of the efforts. Gordon Werkema, who presented at the conference yesterday, is our Payments Strategy Director, overseeing the initiative. We have also established two task forces that will work toward proposed solutions to the goals outlined in the “Strategies” paper: One task force is focused on faster payments and the other on the security of payments. Our Faster Payments Strategy Leader, Sean Rodriguez, chairs the Faster Payments Task Force, and our Payments Security Strategy Leader, Todd Aadland, chairs the Secure Payments Task Force. These three leaders have worked tirelessly to build up wide task-force memberships representing the diverse stakeholders with an interest in the payment system. At last count, the Faster Payments Task Force has 328 members, and the Secure Payments Task Force has 180 members. I would encourage you to take a look at the breadth and depth of the current task-force memberships on our web page FedPaymentsImprovement.org. You’ll see that there are representatives of financial institutions of all sizes, payments networks, trade associations, technology companies, business end users and consumers, and a small number of government officials. You’ll also notice that members of The Clearing House, likely several people in this room, serve on each task force. These task forces have chosen steering committees and have set up a framework for ensuring that task-force decisions and work products have broad support across members; work streams are now underway.

The Faster Payments Task Force has completed and gathered public comment on a draft set of criteria that will be used to assess whether proposed alternative approaches will be effective in delivering a safe and, ubiquitous faster-payments capability. These criteria fall into six categories: ubiquity, efficiency,

safety, speed, legal considerations, and governance. The criteria are not meant to be a set of minimum requirements. Many of the criteria may involve a tradeoff, for example, speed vs. safety. The criteria are intended to differentiate the effectiveness of solution proposals across many dimensions. The effort is on track to finalize these criteria in coming months. Work is also progressing on defining a process for encouraging the best ideas on faster payments to come forward and for assessing proposals against the effectiveness criteria.

The Secure Payments Task Force has also begun its work, focusing not only on the security of the future faster payment system, but also on the security of the current payment system. It has provided input to the Faster Payments Task Force on the effectiveness criteria pertaining to security against which a faster payment solution should be assessed. These include identity management, authentication, and ways to secure sensitive information as it travels through the payment system. Regarding the current payment system, the Secure Payments Task Force is considering better methods to share and analyze fraud and cyber-threat information. Another role of the task force is advising the Fed on ways we could improve security in the payments areas in which we are already involved, including determining priorities for developing and setting payment-security standards in these areas, and identifying issues related to payment-system security and resiliency that would benefit from additional research. Work is currently underway to determine high-priority areas for which work groups will be formed in the next few months.

I hope that you can see from this brief overview that in just a short period of time a lot has been accomplished. But we all recognize that there is still much more to do. The Federal Reserve is committed to facilitating these collaborative efforts with payment stakeholders on behalf of the public, because at the end of the day, the promise of a ubiquitous, faster, secure payment system is worth it.