At What Cost Do Faster Payments Come? Current Payment "Rails," Faster Alternatives, and Math-Based Currencies?

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Introduction

This presentation focuses on three topics: developments in current payment "rails," risks and benefits of faster payments, and the role math-based currencies are playing and may play in the payments market.

These subjects link to various legal work streams, including work with which I am involved with the Uniform Law Commission, the American Bar Association, a treatise to which I contribute, and periodic opportunities to testify before Congress or agencies. Some of these topics will arise in connection with other presentations during this Symposium.

Current Payment Systems “Rails”

- MasterCard, Visa, Discover, etc.
- Other bank products
- Non-bank providers’ products such as PayPal and Google Wallet
- Apple Pay (coming soon to a smartwatch near you)
- ACH transactions offered by Fedwire, Chips, and via the NACHA Operating Rules over bank and other significant legacy systems
- Third-party payments processors

Current Payment Systems “Rails”-- two

- Have technology and legal underpinnings.
- Serve traditional transaction execution, protect value storage/redemption rights, and allow prudential supervision in particular silos of payments activity.
- Larger number of bank and non-bank participants in the United States than in the UK, for example, may complicate transitions from current rails to newer, faster options.
- Duality of our legal and regulatory regimes – with federal as well as State laws – is a strength.
- Larger number of regulators and their mixed roles also a factor that alters pace of change from current systems, while also relying on them for some innovations such as mobile payments flowing across current debit and credit rails.

Current Payment Systems “Rails” -- three

- Changes require attention to some basic legal issues as well as to the technology and infrastructure investments that may be required.
- Frequently we must ask if a new approach is needed to frame the new product legally or whether end users, providers, and the market generally are better served by adjustments to established frameworks (as certain provisions of the Electronic Fund Transfer regulations have been adapted to suit payroll and prepaid cards).

Current Payment Systems "Rails" -- four

- The need to change the legal regime to accommodate emerging payments systems and the new providers that may make them available is the question of the moment both in payments circles and legal/regulatory circles.
- Cases can be made for new approaches for new services – to provide transparent governance and to encourage adoption by end users.
- Governance issues such as those highlighted in the excellent paper by Kristin Wells and Bruce J. Summers show that the choices of using existing regulatory frameworks and system rules or crafting newer rules is not always a clear choice.
- Some providers will argue that new products and systems should not be regulated because regulation chills innovations – a thought that should remind everyone of what e-commerce providers were saying 20 years ago.

Current Payment Systems "Rails" -- five

- Cases can be made to adjust existing approaches – to reduce potential regulatory overlap and attendant costs.
- Not always clear that forging new rules is a better approach, and they may have the effect of chilling innovation that adjustments to existing rules that provide a background for innovators would not do.

What Generic Costs Attend Faster Payments?

- Risk management models need to adapt to faster payments.
- Pricing models need to change for faster payments, and mispricing of services.
- Risk allocation models need to change for faster payments.
- Legal changes required to accommodate these risks and to manage the execution of these payments.

Other Costs of Faster Payments

- Hard to calculate costs to alter payments infrastructure in a multi-faceted payments environment such as the United States. Much bigger task in scale from that undertaken in the U.K., and many more payment system participants, in the bank and non-bank sectors.

- Costs Associated with Fraudulent Transactions. Bob Olson of Unisys recently observed, “It’s not an indictment of the concept to say faster payments would certainly attract fraudsters, and we might see fraud rise at first until we batten down the hatches. As any bank representative in the UK can tell you, following the launch of Faster Payments, they saw fraud rise sharply the first year, then slightly in the second year, and then decrease in subsequent years, almost down to pre-launch levels.”

- Need for stronger user validation and verification methods.

Other Costs of Faster Payments -- two

● Need for stronger rules managing fraud-associated externalities, such as fees imposed for handling unauthorized transactions and payments to system participants bearing the costs of unwinding them, such as NACHA will launch in September, 2015.

● Other Costs of Implementing Faster Technologies and Training Employees and Vendors.

● Possible limitation by contract or otherwise of error-resolution and reversibility rights for consumers if they do not appreciate that certain payments choices have fewer post hoc protections, and resultant losses for consumers and increased cost of resolving consumers' complaints.

●Risks of low or slow adoptions by end users.

● A "zero day threat" – a hazard so new that no viable protection against it exists. Byron Acohido & Jon Swartz, ZERO DAY THREAT (Sterling 2008).

Benefits of Faster Payments

- Shorter "float times."
- Greater certainty for payments recipients, both consumer and merchant.
- Higher velocity in the economy.

Which Market Participants Benefit from Faster Payments?

- End users, particularly retail merchants and those buying lower-dollar-value goods or services or "virtual goods."

- Hackers and others exploiting vulnerabilities in payments systems.

Which Market Participants Might Incur Costs from Faster Payments?

- End users, retail merchants and their customers.

- Bank and non-bank payment system participants who deal with unauthorized transactions.

- Users less familiar with the speed costs of differing payments options.

Uniform Law Commission Study Committee on Alternative, Math-Based Payments Systems

- Formed last February to look at math-based and mobile payments. ULC Commissioners are responsible for the drafting of model laws and work with the States and the American Bar Association to develop model laws and with the American Law Institute to develop amendments to the Uniform Commercial Code.
- The Chairman of this Study Committee is former ULC President Professor Fred Miller. I am the reporter for this project.
- We have issued three reports to the Committee and the Advisors selected by the American Bar Association and observers who select themselves. Observers are welcome.
- The most recent report sets the stage for preparation of a white paper that we hope to submit to the ULC's Committee on Scope and Program in January, 2015 to dovetail to the degree feasible with the work of the Conference of State Bank Supervisors.
- The review process and the coordination with the ABA suggest that this project could not move to a Drafting Committee stage for a few months after the report is submitted, and legislation would take at least one year after that and possibly more.

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Some Recent Resources

- Bruce J. Summers & Kristin E. Wells, *Governance of payment systems: A theoretical framework and cross-country comparison,* July 2014 (copy on file with Federal Reserve Bank of Chicago and with the authors).
- NACHA, *Improving ACH Network Quality – Unauthorized Entry Fee* (eff. Sept. 18, 2015).
- NACHA, *ACH Network Risk and Enforcement Topics* (eff. Sept. 18, 2015).
- Bob Olson, *5 Questions about Faster Payments in the US*, INFORMATION WEEK-BANK SYSTEMS & TECHNOLOGY (Aug. 7, 2014 11:20 AM), http://www.banktech.com/payments/5-questions-about-faster-payments-in-the-us/a/d-id/1297854.
- Edward Castronova & Joshua A.T. Fairfield, *The Digitial Wallet Revolution,* NEW YORK TIMES (Sept. 10, 2014), at www.nytimescom.

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