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VIA EMAIL: regs.comments@federalreserve.gov

Ann Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

RE: Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, [Docket No. OP-1625, FRS-2018-0351-0001]

Dear Secretary Misback,

The National Association of Convenience Stores ("NACS") and the Society of Independent Gasoline Marketers of America ("SIGMA"), referred to collectively as "the Associations," submit this letter in response to the Board of Governors of the Federal Reserve System's ("FRB" or "Board") request for comment on potential actions to promote ubiquitous, safe, and efficient faster payments in the United States (hereinafter the "RFC").[1]

It is imperative that the Federal Reserve update the nation's payment infrastructure to support faster and more efficient payments—and it is critical that the Board do so expeditiously. The United States' payments system and infrastructure already lags that in place in other countries, a reality that is hurting the U.S. economy and the businesses that form its foundation. For this reason, NACS and SIGMA enthusiastically support the FRB's intention to update the U.S. payments system and specifically encourage the Board to upgrade and enhance the payments system via implementation of real-time gross settlement ("RTGS"). Compared to deferred net settlement, RTGS is faster and more efficient, and the most effective path by which to update our system. Should the FRB lead the transition to RTGS, it will provide a critical public benefit because it will upgrade the U.S. payments system with respect to speed and efficiency. Moreover, any costs to adjust the nation's system (or potential disruptions), will be far outweighed by the benefits of creating a RTGS service.

<u>The Associations strongly urge the Federal Reserve to take an active role in the transition process in order to assure competition in the payments space</u>. Not only should the FRB develop a RTGS

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[1] Board of Governors of the Federal Reserve System, Request for Comment, Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, 83 Fed. Reg. 57351 (Nov. 15, 2018), https://www.regulations.gov/document?D=FRS-2018-0351-0001.

service, it should also administer it, for the private sector will not do so or would do so poorly. Historically, in systems where the Federal Reserve has been an active participant (and service provider), such as the automated clearinghouse ("ACH") system, the system is marked by cost and process efficiency, competition, and transparency. In contrast, systems where the FRB has not been an active participant (e.g., the payment card marketplace) are notable for their anticompetitiveness, inefficiency, opacity, and fraud. Essentially, the country cannot and must not depend on incumbent financial services market players to drive faster payments innovation—only the Federal Reserve will make this happen effectively for it is the only entity that has the right incentives to accomplish such a transition and do so without using its role to block healthy market competition from the marketplace.

Finally, as the Federal Reserve develops a faster payments infrastructure via RTGS, the Associations urge the Board to enlist participation and feedback from a broad range of key stakeholders, including, but not limited to, merchants, consumer advocates, payment processors, financial institutions, financial technology firms, and related financial network service providers. More in-depth comments on the Board's RFC can be found below.

I. THE ASSOCIATIONS' MEMBERS PROCESS 60 BILLION PAYMENT TRANSACTIONS PER YEAR, YET THE INDUSTRY IS MADE UP PREDOMINATELY OF SMALL BUSINESSES THAT OPERATE ON NARROW MARGINS.

The convenience store and fuel retailing industry as a whole operates more than 154,000 stores across the United States.[2] In 2017, the convenience and fuel retailing industry employed nearly 2.5 million workers and posted $601.1 billion in total sales, representing approximately 3.1 percent of the U.S. GDP.[3] In light of the number of fuel and other transactions that our industry engages in, we handle approximately one of every 32 dollars spent in the United States. These retailers serve more than 165 million people per day—around half of the U.S. population.

Yet, it is truly an industry of small businesses—63 percent of convenience store owners operate a single store, and approximately 80 percent of NACS' membership is composed of companies that operate ten stores or fewer. The retail convenience store and fuel market is one of the most competitive in the United States. NACS members operate on small profit margins (around 1.7 percent) and are unable to absorb incremental cost increases without passing them on to consumers. In 2017, the industry paid $10.1 billion in card fees compared to $10.4 billion in pre-tax profits.[4] In fact, swipe fees associated with payment card transactions are the second highest operating expense for convenience stores—second only to labor.

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[2] NACS is an international trade association representing the convenience store industry with more than 2,100 retail and 1,600 supplier companies as members, the majority of whom are based in the United States. SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel.

[3] All of the data points about the convenience store industry come from the NACS, State of the Industry: Annual Report (2017).

[4] NACS, State of the Industry: Annual Report (2017).

II. COMMENTS ON THE FEDERAL RESERVE'S POTENTIAL ACTIONS

Updating the nation's payment system so that it can process real-time transactions would benefit the market and the broader economy. As such, NACS and SIGMA support the Federal Reserve's goal to update the payment system to allow for faster processing. Specific feedback on the RFC is laid out below.

A. The Federal Reserve should develop a real-time gross settlement service that is available to conduct settlement on a 24x7x365 basis.

The Associations call upon the FRB to develop and operate a 24x7x365 RTGS as it has laid out in the RFC. Although the United States was once a leader in the payments space, it has, over the past thirty years, ceded its leadership to other nations. Those nations have fostered financial innovation by supporting faster payments and marketplace competition. The U.S. payments market, in contrast, is notable for its anti-competitiveness; it is weighed down by incumbent players who remain profitable by stifling innovation. It is unsurprising, therefore, that the U.S. payments system is outdated and slow. Unfortunately, it is also inefficient, unreliable, and less secure than the payments systems of its first world competitors.

Thus, the time has come for the Federal Reserve to bring the U.S. payments system into the 21st century via RTGS. Moreover, the Associations believe that the Board should be developing faster payments capacity via RTGS as opposed to deferred net settlement ("DNS"). DNS, while it would be an improvement to existing capabilities, is not as fast nor as efficient as RTGS. Thus, in light of the investment that will be necessary to improve our payments system, NACS and SIGMA believe and encourage the Federal Reserve to move forward with the most technologically relevant option at this time: RTGS.

B. The Federal Reserve is the proper entity to develop and administer a RTGS system.

The history of the payments space in the United States illustrates that unless the FRB initiates RTGS, this evolution will not happen—or it will happen at too slow a pace and be rife with inefficiencies. When establishing the Federal Reserve in 1913, Congress had witnessed the failure of the country's check-collection system and intended for the Federal Reserve to serve both as an operator and as a regulator in the payments system.[5] In short, Congress intended for the FRB to be an active participant in the nation's payments system; and the Federal Reserve has done so successfully. Among other accomplishments, the FRB was critical in developing the nation's ACH system—and the Federal Reserve's leadership in ACH is an excellent example of how its participation in the payments system can foster profitable efficiency in the market.[6] There, the Federal Reserve began and continues to serve

[5] The Federal Reserve Act of 1913, Pub. L. 63-43 (Dec. 23, 1913), codified at 12 U.S.C. §§ 221 to 552.

[6] According to a Government Accountability Office report, relevant financial market stakeholders (e.g., banks, credit unions, and providers of payment services) stated that the "Federal Reserve has an important role to play in the payment system. Several market participants, including those that compete with the Reserve Banks in providing payment services, said that the Federal Reserve successfully promotes ubiquitous access to payment services and should continue to do so." See U.S. Gov't Accountability Office, GAO-16-614, "Federal Reserve's Competition with Other Providers Benefits Customers, but Additional Reviews Could Increase Assurance of Cost Accuracy." (2016), available at https://www.gao.gov/products/GAO-16-614.

as an ACH operator with a pure cost-recovery approach. This participatory approach drove broader ACH adoption and system-wide efficiencies, and, in fact, the ACH system remains a low-cost and remarkably efficient system to this day despite not having evolved to support real-time settlement.[7] The Federal Reserve's operation of ACH also has allowed competitive ancillary services to thrive in a private marketplace. That has delivered private market innovation that builds upon the system built by the Board.

The ACH system stands in stark contrast to the payment cards market, where the Federal Reserve is not a participant.[8] That monopolistic market, which is dominated by a small number of large payment networks, is notable for its lack of competition, opacity, inefficiency, high costs, fraud, and general lack of innovation. There is no incentive for the private companies that control the anticompetitive payment card market to invest in efficient, real-time payments because they derive overinflated profits from their dominance of the current payment card market. Any change that might benefit the market but could add uncertainty or risk to the control exercised by the incumbent networks is routinely opposed by those networks and by the financial institutions that derive large fees from the current arrangement. Thus, the U.S. cannot and must not depend on the incumbent financial services market players alone to drive the future of payments. The FRB is needed to drive that future and to do so in a way that allows current and future market participants to compete to offer ancillary services that increase innovation and efficiency. That is the successful model pioneered by the Federal Reserve with ACH. <u>Only the Board can transition our payment system to RTGS with reasonable speed, effectiveness, scope, and equity for all market participants—so it must make this change and administer it because the private market will not.</u>

C. Transitioning the U.S. payments system to RTGS will provide a clear public benefit.

Today, traditional payment methods, including checks, credit cards, debit cards, and ACH payments, are still used widely. Yet, these payment methods are not fast enough to meet the needs of the modern economy. Unsurprisingly, therefore, the U.S. payments system becomes more outdated and archaic by the day while the systems in other countries, which have focused on faster payment technologies, advance. This is a serious problem. If it is not corrected, it will lead to negative outcomes for the U.S. economy as well as U.S. businesses and consumers.

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[7] NACS and SIGMA members process at least 300 million payment transactions per year using the ACH system. The ACH system is currently a critical low-cost alternative payment method for retailers and ACH transactions serve as an important alternative to credit card transactions, which have exorbitant swipe fees attached to processing and are thus extremely costly for our members. Currently, processing a check via the ACH system costs some NACS members less than half the cost of debit transactions that are limited according to Federal Reserve rules and less than one quarter of the cost of debit transactions that are not subject to Federal Reserve rules. (See Understanding the Federal Reserve's Proposed Rule on Interchange Fees: Implications and Consequences of the Durbin Amendment: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services, 112th Cong. at 54 (Feb. 17, 2011) (Response to Rep. David Scott (D-GA) by Mr. Brian Seltzer, 7-Eleven), available at http://financialservices.house.gov/uploadedfiles/112-8.pdf.) And, credit card transactions are even more expensive for NACS members than debit card transactions.

[8] Privatized payment systems, if operating in competitive markets, would serve a critical function of balancing profit and market benefit, but this is clearly not the case today. In the absence of truly competitive markets, the public benefit of electronic payments must be established by central authority until competition in private markets can flourish. In this manner, the Federal Reserve successfully implemented ACH, drove adoption and efficiencies, all while creating market space for private associations to compete and improve the system.

Transitioning to RTGS would mean that the U.S. would be upgrading its payments infrastructure to support the fastest and most efficient system currently available. This speed and efficiency would provide clear public benefits for it would ensure that funds flow quickly and smoothly between and among consumers and businesses. For example, businesses would flourish by having the capacity to instantaneously use a consumer payment to replenish inventory or invest in a new product or business expansion; and consumers would benefit via real-time bill pay options, enhanced employer payroll capabilities, or instantaneous refunds for returned products.[9]

The success of a transition to RTGS, of course, will depend on its ubiquity or accessibility. And, the best way to achieve ubiquitous RTGS will be to ensure platform interoperability. This is exactly what occurred in the ACH system where ACH operators use common format or processes to communicate and permit fund settlement across the system and financial institutions have the capacity to select the ACH operator that is most attractive for their specific needs. (See more on this in Section F below.) Certainly, however, a transition to RTGS spurred and managed by the Federal Reserve would benefit the public because it would enhance accessibility as well as efficiency and safety. Once the Federal Reserve decides to step in and invest in this space, the market will follow and respond in kind, leading to broader market efficiency. Should the FRB approach the transition to RTGS as it did the ACH system (i.e. with a cost recovery as opposed to a profit-seeking approach), safety and security concerns will not be brushed aside as they have been in the payment card market.

D. If the Federal Reserve develops RTGS in line with how it developed ACH, it will likely achieve cost recovery over time.

The Associations are not in a position to determine with certainty whether the FRB would be able to recover the costs it would expend to upgrade the U.S. payments system to support RTGS. Nevertheless, in light of the ACH system's history, NACS and SIGMA expect that the Board would be able to recoup its costs. This is because the Federal Reserve has shown that it develops infrastructure and operations at a level (e.g., ACH system) that is beneficial to other market players, who are willing to pay for those services. And, because financial institutions generally depend on the Board's settlement services while competing with each other for market share, history shows that those institutions will likely use the Board's RTGS service and drive its adoption—which will ensure that the FRB will recover its costs over time.

Regardless, the primary reason for the Board to develop and implement RTGS services is that the American economy will benefit (many times over) because the efficiency of payment processing will increase dramatically. Ultimately, whether the Federal Reserve achieves cost recovery or not is a secondary or tertiary issue – although we expect it would achieve cost recovery. What matters in this instance is that the U.S. financial system will benefit far more than what the Federal Reserve will ever spend on this effort.

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[9] Today, some employees still prefer to receive their salaries via a "paper check," despite the slow, inefficient, and negative environmental impact. The ability to offer instant payroll transfer, therefore, may convince employees to transition to electronic payments. Similarly, when a retailer offers a refund to a consumer – the time delay that occurs before funds post to a consumer's account can lead many customers, who live paycheck-to-paycheck to be unable to make necessary replacement purchases when they need to or to inadvertently incur overdraft fees. Businesses would also benefit by being able to effectuate real-time payments to contractors and between corporations.

E. **Fraud prevention should be a consideration during the development of a RTGS service.**

While the safety and security of the nation's payment systems is important, it should be a consideration but not be the Board's primary focus here. Fraud prevention services will be needed in the RTGS space, but the Federal Reserve does not need to perform those services. Rather, if the system is designed to support interoperability, efficiency, and competition, fraud prevention services will evolve and be pushed by the system's participants, namely financial institutions and retailers. This is how it works in the ACH system, which exhibits remarkably low fraud rates. (Incidentally, this is also the exact opposite of the payment card system, where the Federal Reserve is absent, marketplace competition is stunted, and fraud rates are unacceptably high.) Thus, the Board need not be the fraud prevention police in the RTGS space. Rather, after establishing the system with consideration for security, it should let the market players be the primary drivers of fraud prevention. In a fair competitive system, market participants will have an incentive to prevent fraud, and will, in fact, develop measures to enhance security.

F. **The interoperability between RTGS services will be critical to ensuring it achieves ubiquity.**

It is imperative that the Federal Reserve ensure any RTGS service it develops be characterized by interoperability. Without platform interoperability, any RTGS service the Board develops will <u>not</u> result in the ubiquitous adoption that is necessary to upgrade the nation's payments system. Stated another way, the service's interoperability will ensure broad adoption of the RTGS services and marked increases in the volume of faster payments. The reason for this is simple, and supported by the ACH experience: when a system is interoperable, many different service providers can compete with one another for market share. Then, institutions that are unlikely to develop such services on their own (i.e., smaller financial institutions and retailers) will nonetheless drive adoption of the service among their accountholders because they will have the ability to choose the optimal provider of settlement services. Furthermore, the Board should consider future-looking interoperability (i.e., interoperability vis-à-vis FinTech, virtual currency providers and other market innovators) as well. In this way, the FRB will encourage innovation by increasing the likelihood that the RTGS service will continue to evolve as technology advances.

III. CONCLUSION

The Associations thank you for the opportunity to provide these comments. NACS and SIGMA stand ready to provide additional feedback and assistance should the Federal Reserve have further questions.

Sincerely,

Douglas S. Kantor
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