



December 13, 2013

The Federal Reserve Banks

Submitted via [comment@fedpaymentsimprovement.org](mailto:comment@fedpaymentsimprovement.org)

**RE: Payment System Improvement: Public Consultation Paper**

Dear Ladies and Gentlemen:

NACHA – The Electronic Payments Association<sup>1</sup> (NACHA) welcomes the opportunity to respond to the Public Consultation Paper on Payment System Improvement (Consultation Paper) published on September 10, 2013 by The Federal Reserve Banks. This letter is intended to address some of the broader themes raised by the Consultation Paper. A more detailed response addressing the specific questions set forth in the Consultation Paper is attached as Exhibit A. We also attach as Exhibit B a copy of NACHA’s “ACH Blueprint,” described further below. This letter and the detailed response, as well as the ACH Blueprint, represent input from our Direct Members, the NACHA Board, and broad industry input via our councils.

Introduction

Since its inception in the early 1970s, the ACH Network has served as a highly efficient electronic alternative to check payments. Significant uses of the ACH include Direct Deposit of payroll, Social Security benefits, and tax refunds; consumer payments for recurring or one-time bills; business-to-business payments; tax withholding and collections; and settlement transactions for some card systems. Over the last decade, additional use of the ACH includes online account-to-account transfers and person-to-person payments; online banking payments; mobile payments; deposits to payroll cards, and funding and reloads for prepaid cards; and healthcare claim payments. In total, NACHA estimates that ACH payment volume for 2013 will be 22 billion transactions<sup>2</sup> – or more than 87 million transactions every business day – transferring an estimated \$40 trillion directly from bank account to bank account.

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<sup>1</sup> NACHA manages the development, administration, and governance of the ACH Network, the backbone for the electronic movement of money and data. The ACH Network provides a safe, secure, and reliable network for direct account-to-account consumer, business, and government payments. Annually, it facilitates billions of Direct Deposit via ACH and Direct Payment via ACH transactions. Used by all types of financial institutions, the ACH Network is governed by the NACHA Operating Rules, which guide risk management and create payment certainty for all participants. As a not-for-profit association, NACHA represents more than 10,000 financial institutions via 17 regional payments associations and direct membership. Through its industry councils and forums, NACHA brings together payments system stakeholders to foster dialogue and innovation to strengthen the ACH Network. To learn more, please visit [www.nacha.org](http://www.nacha.org).

<sup>2</sup> This estimate includes an estimate of “on-us” transactions within a single financial institution.

Through industry dialogue and collaboration, NACHA and both ACH Operators continuously work with the financial services industry to make improvements to the ACH infrastructure, and its governing rule set that provides certainty to all participants in the Network. Uses of the ACH Network have expanded throughout the past ten-to-fifteen years to safely and efficiently encompass the many ways in which end-users choose to transact, whether through check conversion, over the telephone, on the Internet, or via a mobile device. Currently, eighty-five percent of ACH payments are consumer payments, in which a consumer is either the payor or payee of the transaction. In addition, the ACH Network has been a leader in facilitating e-commerce — twenty percent of the total of ACH transaction volume is due to consumer transactions initiated online, offering convenience for consumers to pay bills and transfer funds among accounts. At the same time, NACHA, the ACH Operators and the financial services industry have also adopted and implemented a comprehensive risk management strategy to ensure that the ACH Network remains safe and secure for end-users.

An essential feature of the ACH Network is its ubiquity. Virtually every financial institution in the U.S. participates in the ACH Network. As a ubiquitous system, the ACH Network has the advantage of enabling counterparties at virtually all financial institutions across the country to transact with each other. Ubiquity can often “make or break” payments system innovation, because network effects that exponentially increase the value of the system for all participants can only be achieved when new products or services have attracted sufficient numbers of users from both sides of a transaction. Early participants can therefore find it challenging to develop a business case for participation in a new payment service unless there is confidence that there will be sufficient numbers of counterparties on the other side of their transactions. The ACH Network is well-positioned to enable payment systems innovation because it already links a nationwide system of sending and receiving institutions in a way that provides the backbone for new payments products and services.

Because changes to the ACH Network can affect all financial institutions in the U.S., and can potentially affect end-users as well, NACHA employs a rulemaking process that is participatory, deliberative and transparent, ensuring that changes to the rules and the infrastructure have broad-based support. This rulemaking capability has adapted to serve the industry well for the past forty years, and we can continue to support the industry with this capability as new payment systems evolve.

#### General Themes Raised by the Consultation Paper

NACHA is generally supportive of the overarching vision for the future of the payments system that is articulated in the Consultation Paper, and we note that many of the major themes in the Consultation Paper are very similar to those articulated in NACHA’s “ACH Blueprint” of 2012 (described in Section 2 below). The following are NACHA’s thoughts on the most significant themes raised by both the Consultation Paper and our review. More extensive and detailed comments are also provided in our response (Exhibit A) to the specific questions posed by the Fed in the Consultation Paper.

1. Further Articulate Use Cases for Near-Real-Time Payments

The Consultation Paper articulates a vision for “near-real-time payments” in the U.S. NACHA agrees that there are a number of payments use cases that would benefit from being near-real-time. We recommend that the Fed further analyze and differentiate, within the framework of its vision, these use cases to determine which would truly benefit from being near-real-time, and others that are either well served today by existing payment system features or that could be better served with incremental improvements to existing features.

For example, NACHA agrees that some use cases for emerging types of person-to-person payments and mobile payments would be substantially improved from being near-real-time. We also note that within these types of use cases, a further distinction should be made between near-real-time *payments*, and near-real-time *messages* about payments.

As an illustration, consider a hypothetical person-to-person electronic payment in which the recipient might experience a near-real-time feature in one of three ways: 1) the recipient receives a near-real-time *message* that the payment has been initiated, with funds availability to follow according to the rules of the specific service or the payment system; 2) the recipient receives a near-real-time *payment*, in which the payment system infrastructure has moved funds to the recipient’s bank and in which the bank also has made funds available in the recipient’s account, all in near-real-time; and 3) a hybrid method, in which the recipient receives a near-real-time *message* and some amount of funds also are made available in the recipient’s account in near-real-time based on payment system rules, while inter-bank settlement occurs sometime into the future. Any one of these three models might be the desired outcome for a specific use case, depending on the specific needs of both senders and receivers, and the economic and risk underpinnings of the system and service providers.

As points of comparison, other systems in the U.S. and in other countries have implemented near-real-time systems based on each of these three types of illustrations above. Examples are clearXchange in the U.S. (which works like illustration #1); Mexico’s “SPEI” system (which works like illustration #2); and the UK’s Faster Payments (which works like illustration #3).<sup>3</sup>

NACHA thinks that there are many types of payments use cases that are either well-served today by existing payment system features or that could be better served with incremental improvements to existing features. For example, card-based point-of-sale payments work similarly to illustration #1 above. A merchant receives a *message* in real-time from the cardholder’s bank that a payment is authorized; actual funds are settled between banks and made available to the merchant generally in 1-2 business days (most often via an ACH credit to the merchant’s bank account). These transactions generally carry a guarantee of payment, and card networks have made a substantial number of other system improvements over time to support the needs of end-users. As noted, a merchant receives a message in real-time that a card payment is

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<sup>3</sup> NACHA notes that in a system such as Faster Payments, near-real-time funds availability is supported by multiple daily inter-bank settlements. Faster funds availability without more frequent inter-bank settlement would have the unintended effect of increasing settlement risk in the system.

either authorized or declined, allowing the merchant to quickly conclude the transaction with the customer, but without having to wait for the finality of an actual funds transfer.

There are many uses of the ACH for which the benefit of being near-real-time is not clear. These include payroll payments by Direct Deposit; consumer bill payments; and business-to-business payments. In the vast majority of these types of payments, the counterparties are known to each other, and payment due dates are known in advance. The existing ACH infrastructure and processes enable these payments to be authorized and initiated in advance.

Some of these use cases would benefit from moving faster than they do today (i.e., with same-day posting and/or settlement of funds) without necessarily being near-real-time. For example, a same-day payroll capability would benefit employers that need to make payments to significant numbers of hourly employees, or that through errors or missed deadlines need to make an emergency payroll. Similarly, consumers would benefit from being able to execute a same-day bill payment in some situations (i.e., the bill is due today and therefore needs to be credited to their account by the end of the day).

Another important feature of these existing types of ACH payments is that they be maximally efficient, by which we mean the ability for ACH Network participants to move and process large volumes of payments at a relatively low societal cost. Over-engineering a near-real-time system could have the unintended and undesirable consequence of increasing the societal cost for many types of payments for which a near-real-time capability would not materially improve the overall utility of the payment.

Finally, there are many existing payments products and services that have some of the “missing features” noted in the Consultation Paper. For example, as referenced, card systems use near-real-time messages, and because transactions are authorized by cardholders’ issuers, are based on good funds. Most ACH credit payments are also based on good funds. More directly relevant to the vision articulated by the Consultation Paper, there is an ACH service that provides most of these features for ACH payments and could be leveraged to achieve objectives: Secure Vault Payments.

Secure Vault Payments today provides the functionality for a near-real-time payment authorization and guarantee to a merchant or biller, followed by an ACH credit payment based on good funds. The service is supported by a participant directory so that the ACH credit is properly routed to the merchant or biller. The consumer does not need to know the banking information of the merchant/biller, and the merchant/biller does not need to obtain or know the banking information of the consumer. In the future, the industry could leverage the Secure Vault Payments model for mobile payments, as well as scenarios for person-to-person or business-to-business scenarios.

The key barrier that Secure Vault Payments has yet to overcome is ubiquity; since Secure Vault Payments is an optional ACH service it cannot achieve the network effect described above without sufficient volumes of users on each side of the transaction. Consumers don’t use it if their financial institutions don’t participate; financial institutions don’t participate if there aren’t enough merchants that accept it; merchants don’t accept it if there aren’t enough customers that

will use it. This “chicken-or-the-egg” problem is difficult to overcome, as each potential participant waits for critical mass on the other side of the system before joining.

EBIDS – the Electronic Billing and Information Directory Service – also meets some of the real-time features envisioned by the Consultation Paper with respect to ACH payments. Through the EBIDS directory, participating billers can route bill summaries to consumers’ financial institutions for presentment to the consumers, and receive exception-free, good-funds ACH credit payments in return. Like Secure Vault Payments, EBIDS is an optional service that could be used to achieve the objectives outlined in the Consultation Paper, but that also has faced some of the same challenges in achieving ubiquity as Secure Vault Payments.

These examples demonstrate two points: 1) the technology exists today to layer additional functionality on top of existing payment systems to provide incremental value; and 2) ubiquity of adoption across all financial institutions is frequently necessary to delivering that value. As a general matter, the Federal Reserve could look for opportunities among payments innovations to create or support a network effect to achieve such ubiquity.

## 2. NACHA’s Vision for the Future of the ACH Network is Aligned with the Consultation Paper

NACHA has expended, and continues to expend, significant effort to identify areas of opportunity for improvement of the ACH Network and to implement changes where value can be realized. Many of the opportunities identified by NACHA through this effort are aligned with the opportunities identified in the Consultation Paper. In fact, in 2012, after conducting extensive research and soliciting input via one-on-one interviews from over 50 individual organizations over an extended period, NACHA developed the “ACH Blueprint,” which is intended to serve as a roadmap for informing and guiding our approach for making desired changes to the ACH Network over the next 10 years.

Major themes of the ACH Blueprint include:

- Enabling consumers and small business to easily initiate ACH credit transfers from their own deposit accounts, supported by the necessary infrastructure and directories to enable the routing of these payments to recipients without having to know their full banking information;
- Implementing near-real-time payment-related messages for desired use cases, supported by additional daily ACH settlements;
- Enhancing the remittance information capacity and formats of the ACH Network for both business and consumer payments;
- Enabling and removing barriers to cross-border interoperability of ACH-like retail payment systems.

To achieve these objectives, NACHA envisions an ACH architecture in which a near-real-time messaging system is “layered” on top of the existing ACH Network clearing and settlement system (to which incremental improvements would continue to be made). Additional tools such as routing and account validation directories would serve to fully integrate these two layers.

Ultimately, the ACH Blueprint envisions the broad-based use of enhanced ACH credits as an alternative to checks. Enhancements will better enable the use of ACH credits in many situations where check use is still significant, such as for bill payments, person-to-person payments, and business-to-business payments. Most importantly, if routing functions are created that allow delivery to a receiver with or without a known account number, then ACH credits would have the same “pay anyone” functionality of checks, with the added benefit of the electronic efficiencies and risk reduction provided by the ACH network. The advantages of ACH credits could be further enhanced through the development of near-real-time messaging that could allow for faster funds availability under payment system rules (regardless of the speed of the underlying settlement of funds), and the implementation of additional settlement windows to reduce risk within the system between counterparties. Thus, the ACH credit could be the “ubiquitous electronic solution” for payments made directly from one bank account to another.

*Example of a ubiquitous ACH credit system*

There are approximately 13,000 financial institutions in the U.S.; each holds its customers funds in transactional deposit accounts. These transactional accounts can serve as the foundation for customers of financial institutions of every size and type to initiate ACH credit transfers to the accounts of any other businesses or consumers at all other financial institutions.

The following is a hypothetical example of how the implementation of the major objectives of the ACH Blueprint would result in a ubiquitous, near-real-time account-to-account transfer capability based on good funds, aligning with the vision of the Consultation Paper.

1. A consumer (or small business) logs on to online banking, either via the Internet or via a wireless network using a mobile device, and selects “send money.”
2. The consumer enters the amount, at which time the financial institution verifies that sufficient funds are available in the consumer’s account (i.e., the payment is based on good funds).
3. The consumer provides identifying information regarding the recipient. It could be, but doesn’t have to be, the recipient’s bank routing and account number. It also could be an email address, cell phone number, social media contact, or some other unique identifier specifically developed for this purpose. The consumer could also provide reference information to help the recipient identify the payment; for example, “December Rent” for a payment to a roommate or landlord, or a billing or account reference number for a payment to a biller or merchant.
4. The consumer’s financial institution verifies the recipient’s identifying information in a system database. The system database generates a message to the recipient’s financial institution in near-real-time (e.g., sent within 30 seconds) that the payment was initiated and funds are guaranteed. Per payment system rules, the recipient’s financial institution makes an agreed-upon amount available in the recipient’s account within an agreed-upon time (e.g., 30 minutes).
5. The recipient’s financial institution sends a message to the recipient by whichever method is established by the recipient (i.e., email, text alert, automated phone call).

To effect the actual interbank transfer of funds, the sender's financial institution (the ODFI) originates an ACH credit to the recipient's financial institution (the RDFI), batched with all other ACH credits arising out of the same service. All such ACH credits settle at the next available ACH interbank settlement window.

This illustration above shows a near-real-time payments messaging system that is ubiquitous among all financial institutions, is based on good funds, utilizes a common directory, combines the payment with meaningful information, and uses low-risk ACH credits to achieve the actual transfer of funds.

To support this ubiquitous system, the industry would develop the system infrastructure and rules to provide the account masking, routing and verification capabilities, and to deliver near real-time messages among financial institutions. An increase in the number of daily ACH settlements would reduce risk arising from providing funds availability in near-real-time.

Such a ubiquitous system to enable consumers and small businesses to easily initiate ACH credits would allow financial institutions of all types and sizes to compete in the payments market. Financial institutions that today are only the receivers of ACH payments could become originators of ACH payments, giving them a greater stake in the continued viability of the payment system and help them to directly support the needs of their customers. Attention to formats and rules could also allow for greater interoperability with international systems.

For the benefit of readers of this response letter, NACHA is attaching the ACH Blueprint document as Exhibit B. As stated elsewhere in this letter, we would welcome the opportunity to present the findings and objectives of the ACH Blueprint to the Federal Reserve.

### 3. Available Resources for Investment

While NACHA understands that the Consultation Paper is put forth as a forward-looking vision of the payment system, the Federal Reserve should recognize the broader context of the existing regulatory, compliance and technology environment that the financial services industry operates in today. Without digressing into any of the underlying causes, a significant portion of financial institutions' resources is committed to satisfying myriad new compliance obligations resulting from new statutes, regulations and regulatory expectations. Resources — finite to begin with — that otherwise might be deployed to improve payment system infrastructure and internal systems are instead being committed to other uses.

In order to make investment decisions, the financial services industry will need to identify business cases that support the investments in the infrastructure necessary to enable the features envisioned by the Consultation Paper. This may mean that new economic models will need to be applied to new services in order to justify the investment necessary to bring such services to market. The Federal Reserve will need to be tolerant of these efforts by the private sector.

NACHA recognizes that, like other payment industry participants, the Federal Reserve Banks also are bound by finite resources. To that end, the Federal Reserve and the industry should not expend the additional resources that would be necessary to develop a fully electronic analogue to

the paper check (i.e., the electronic payment order). Such an effort would require a significant level of resources to develop the laws, rules and infrastructure necessary to create a new payment instrument that is not internationally interoperable and is itself modeled on a payment method that is declining in use. Even assuming the industry had the necessary resources available, those resources would be better expended in making improvements to the nation's electronic payments system, such as developing the tools and infrastructure to enable fully electronic ACH credit transfers from any bank account to any other bank account without requiring the production of the recipient's account information. Enhancing these electronic systems would leverage the well-established risk management frameworks and systems already in place for ACH transactions, unlike investments in check technologies that would require substantial investment in new, redundant risk management systems in order to achieve the same benefits to preserve the safety and integrity of the system.

4. Industry collaboration

NACHA commends the Federal Reserve for initiating this dialogue within the payments industry. By our very nature, NACHA creates a forum for industry dialogue and collaboration on payment system topics, most specifically the ACH Network and the *NACHA Operating Rules*. NACHA's history also includes rulemaking for other payment types, and for enhanced capabilities that are layered on top of the ACH Network.

We note that the Federal Reserve is also a practitioner of industry collaboration, and we encourage the Federal Reserve to continue in this role. As a fellow practitioner, NACHA offers our knowledge, experience and rulemaking capabilities in support of the Federal Reserve's ongoing review of improvement of the U.S. payment system. We offer to work hand-in-hand with the Federal Reserve to further define the intersection between the gaps and opportunities identified in the Consultation Paper, and attributes of the future ACH Network outlined in the ACH Blueprint.

Again, NACHA appreciates the opportunity to provide comments on the Consultation Paper. If you have any questions regarding our comments, please do not hesitate to call me at 703-561-1100 or via email at [info@nacha.org](mailto:info@nacha.org).

Sincerely,



Janet O. Estep  
President and CEO

Cc: NACHA Membership  
NACHA Board of Directors