



# **Role of the Federal Reserve in Fostering Efficient Retail Payments**



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# Central banks can use various roles to foster an efficient retail payments

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- Service provider
  - Role influenced by history, legal/policy environment
  - Balancing benefits of competition vs. economies of scale
- Regulator
- Catalyst for change
- Looking to the future



# Central banks' roles in providing retail payment services vary

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- Although RTGS services are considered core central bank services, not all central banks provide retail payment services
- Federal Reserve retail payment services
  - Check (roughly 35% market share)
  - ACH (roughly 50% market share)



# History can influence whether a central bank provides retail payment services

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Why does the Federal Reserve provide some retail payment services and not others?

Services Fed provides

- Check (1910s): Was the primary wholesale payments system in the U.S.
- ACH (1970s): Leveraged check infrastructure; supported Treasury fiscal agent role

Services Fed does not provide

- Card-based services: Concluded there was no need for central bank intervention; lack of synergies with other services



# Central bank's role as service provider may depend on its legal environment

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- Does central bank have authority to provide retail payment services?
- If yes, are there any legal requirements that must be met?
  
- Federal Reserve Act does not restrict Fed's authority to provide retail payment services
- Fed must price services to fully recover costs (Monetary Control Act of 1980)
  - Must recover, over the long run, all actual costs (direct and indirect) and imputed costs and profit
  - Fed publishes its fee schedule and cost recovery annually



# Central banks should consider how to balance benefits of competition and economies of scale

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- Key issue: Is market large enough to support multiple service providers?
- Central bank full-cost service pricing can foster competition, which –
  - Promotes innovation in product offerings
  - Provides incentive to control costs (but may deter investment in security and resiliency)
- Monopoly provider allows for greater economies of scale
  - Fixed costs spread over greater volume
  - But... may reduce innovation and lead to cost inefficiencies



# Policy considerations may be relevant in a (potentially) competitive environment

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- Federal Reserve criteria for entering new services
  - Fed would be able to fully recover costs over the long run
  - Fed entrance would provide a clear public benefit
  - Other providers alone cannot be expected to provide the service with reasonable effectiveness, scope, and equity
- Competitive impact analysis required
  - Would proposal have a direct and material adverse effect on the ability of other service providers to compete effectively with the Fed in providing similar services due to differing legal powers/constraints or a dominant market position of the Fed deriving from such legal differences?
  - Objective: Provide a level playing field for private-sector competitors

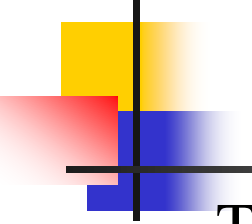


# Some central banks can use regulatory authority to foster efficiency

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- Congress granted the Federal Reserve authority to regulate aspects of the interbank check system
- Fed has used this authority to improve efficiency
  - Providing a faster, more efficient mechanism for returning unpaid checks
  - Improved legal rights of correspondent banks so that they could better compete with the Fed in the provision of check services
- Fed also implements other, more specific, laws governing retail payments



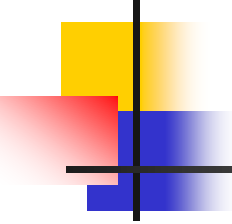


# Central banks can use their stature as a catalyst for payment system improvements

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The Federal Reserve has used its status as payments expert and objective party to promote payment system improvements

- Removing barriers to innovation
  - Transition from paper-based to electronic check collection system (Check 21 – drafting statute; providing services)
- Industry processing improvements
  - High-speed image capture for check processing
  - Same-day ACH
  - Standards for international ACH transactions
- Understanding payments system through research
  - Triennial payments study



# Central banks should continue to focus on retail payments efficiency in this quickly evolving market

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The Federal Reserve's mission to foster the safety, efficiency, and accessibility of the U.S. payments system remains unchanged. Our future focus for retail payments will be to promote –

- *Faster* payments
- *More efficient* payments (especially B2B, P2P)
- *More secure* payments
- *End-to-end*, not just interbank

Requires collaboration with payment services providers and end users.