

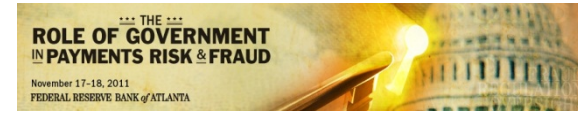


Rationalizing Laws and Regulations: The Harmonization Conundrum

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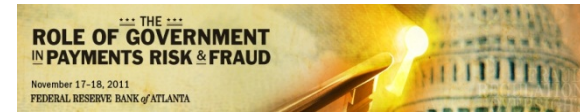
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The Case for Payments Law Harmonization



- Payment systems and mechanisms in the United States are governed by a patchwork of federal and state laws and regulations, as well as private rules and agreements
- As payment mechanisms evolve and payment systems/channels converge, it is increasingly difficult for payments system users and providers to discern their rights and obligations with respect to a particular payment transaction
- As numerous examples show, existing bodies of payments law are too numerous, often redundant and sometimes contradictory
- Further, as payments system innovation outpaces the scope of current legal frameworks, certain existing payments laws begin to look obsolete

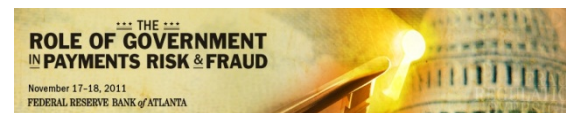
Objectives of Payments Law Harmonization



- Any effort at payments law harmonization must be approached with four principal objectives in mind:
 1. Establish **certainty and clarity** of participant rights and responsibilities *within* payment types
 2. Promote **consistency** of participant rights and responsibilities *across* payment types
 3. Protect the **flexibility** of payment processing to enable participants to utilize the most current and efficient technologies
 4. Develop **sufficiently broad** payment system laws and rules to permit innovation without unnecessary regulatory interference or constant need for amendment

Options for Harmonization

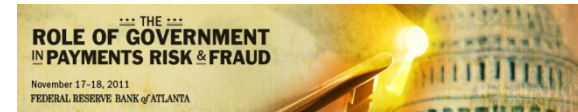
- Payments law harmonization can have different meanings (e.g., harmonize consumer protections v. harmonize provider rights and liabilities). Some harmonization options include:
 1. Harmonize existing federal consumer protections within and across electronic payment types
 2. Establish a uniform body of federal consumer protections governing *all* payments types, electronic and paper
 3. Establish federal financial soundness requirements for payments service providers (to protect all users)
 4. Establish uniform rights and liabilities governing payments service providers (to protect users and promote clarity/efficiency among providers)
 5. Create a uniform federal law to accomplish all of the above



1. Harmonize Existing Federal Consumer Protections Across Electronic Payment Types

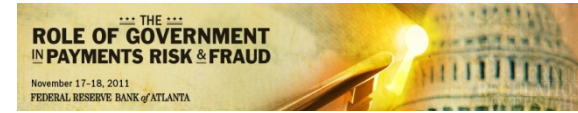
- Harmonize existing federal consumer protections across electronic payment types (ACH, debit card and credit card), including:
 - Error resolution procedures
 - Initial disclosure requirements
 - Periodic statement requirements
 - Consumer liability for unauthorized transactions
- Consumer protections for certain payment types would be consistent based on identity of the transaction originator (consumer v. non-consumer) rather than the payment instrument used in the transaction

1. Harmonize Existing Federal Consumer Protections Across Electronic Payment Types



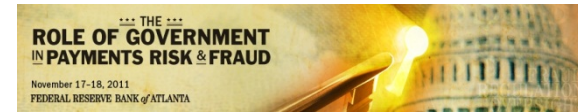
- **Benefits/Opportunities**
 - Harmonizing existing federal consumer protections across all electronic payment types would provide consumers with more consistent, understandable and predictable protections
 - Compliance costs for providers of multiple consumer payment products should be reduced (in the long run)
 - Consolidation of federal authority in the CFPB may create an improved opportunity for this type of harmonization
- **Risks/Challenges**
 - Inherent differences in existing payment types contributed to existing divergent consumer protection regimes and may preclude complete harmonization (e.g., credit v. debit)
 - Overhauling the existing (albeit siloed) consumer protection laws associated with various electronic payment types would be disruptive and costly for providers adapted to existing regimes
 - Absence of a single enforcement authority would undermine certainty and consistency even if a unified legislative/regulatory approach were adopted (e.g., Title X of Dodd-Frank authorizes state enforcement of federal consumer protection laws)
 - Unless federal law preempted all state laws, inconsistency would persist
 - Certain instruments (e.g., prepaid cards, domestic wire transfers and checks) would continue to be governed by non-uniform state laws

2. Establish a Uniform Consumer Protection Regime Across *All* Payment Types



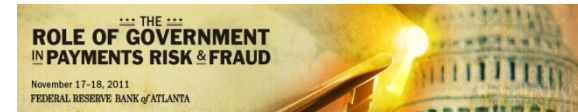
- Establish a single, harmonized federal consumer protection regime across *all* payment types (ACH, debit card, credit card, prepaid card, check and consumer wire transfer), including:
 - Error resolution procedures
 - Initial disclosure requirements
 - Periodic statement requirements (as applicable)
 - Consumer liability for unauthorized transactions
- Consumer protections for all payment types would be consistent based on identity of the transaction originator (consumer v. non-consumer) rather than the payment instrument used in the transaction

2. Establish a Uniform Consumer Protection Regime Across *All* Payment Types



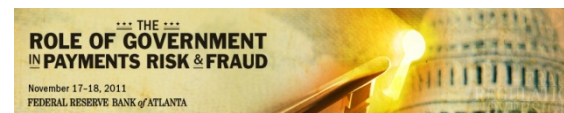
- Benefits/Opportunities and Risks/Challenges include those applicable to option 1, plus
- Benefits/Opportunities
 - Omnibus, harmonized federal consumer protection law would eliminate uncertainty as to applicable body of law for consumer protection regardless of payment type
 - Should even further reduce provider compliance costs (in the long run)
- Risks/Challenges
 - Would require federalization of certain existing state laws (e.g., check law when consumer involved) – creates federalism/states’ rights issues
 - Significant differences in the origins and uses of payment types may justify different treatment (e.g., cash-funded wire transfers v. account-funded EFTs)
 - Would require a very high level of industry coordination to achieve
 - Legislative intervention of this magnitude is very risky – opening Pandora’s box

3. Establish Financial Soundness Requirements for Payment Services Providers



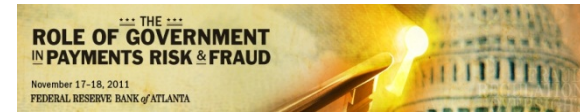
- Establish a federal regime creating baseline solvency and financial soundness requirements to mitigate default by payment services providers (similar to state money transmitter laws)
- Benefits/Opportunities
 - Would protect payments system users from financial loss by establishing baseline financial stability requirements for payment services providers
 - Would create a more level playing field between bank and non-bank payment services providers
 - Limited legislative intervention would leave intact most private network rules/bilateral agreements governing payments systems
- Risks/Challenges
 - Requires entirely new regulatory approach at the federal level (albeit somewhat akin to Dodd-Frank Title I/Title VIII requirements for non-bank financial companies/financial market utilities)
 - May stifle innovation due to enhanced financial barriers to entry

4. Establish Uniform Inter-provider Rights and Liabilities for Payment Services Providers



- Codify a uniform set of rights and responsibilities for payment services providers, including allocation of legal, financial and operational risks – displacing existing private system rules and bilateral agreements (e.g., Visa and NACHA rules)
- Benefits/Opportunities
 - There is some evidence that existing private system rules may not allocate rights and responsibilities in a manner that maximizes social and payment system user welfare (debatable examples include card interchange and allocation of fraud and data security risk)
 - Congress has recently shown an increasingly interventionist propensity in areas where participants and/or operators are seen as failing at self-regulation (e.g., Durbin Amendment)
 - Government intervention may help to establish uniform industry standards where they are not otherwise quick to arise through independent industry efforts (e.g., uniform data security standards)
- Risks/Challenges
 - Network/association rulemaking and bilateral agreements permit payment system participants to allocate rights and responsibilities in a way that aligns with incentives and market dynamics
 - Legislative and regulatory schemes are relatively inflexible and do not adapt quickly to innovation and payments system evolution; private system rules are generally more dynamic and adaptable

5. Create a New Federal Legal Regime Governing All Payment Types and All Users and Providers



- Establish a new, unified statutory regime governing all payment types, systems and parties, specifying the rights and responsibilities with respect to initiation, settlement, finality, recordkeeping, system operation, and reversal/chargeback/put-back rights
- Would govern end-to-end aspects of consumer and non-consumer payments
- Benefits/Opportunities
 - A single, uniform payments law would govern all payments and all parties to those payments (users and providers), promoting consistency and ease of use
 - Federal law would establish a uniform standards for provider-provider and provider-user relationships
- Risks/Challenges
 - May be constitutionally suspect
 - End-to-end revision of existing payments laws would be very disruptive to providers and all aspects of existing payment systems
 - Pandora's box!

Key Takeaways . . .

- Payments law harmonization makes theoretical sense, but any large-scale harmonization effort will be practically difficult to achieve because of the industry-wide consensus and coordination required
 - The largest industry participants with dedicated product teams may view burden of upheaval as exceeding benefits to simplified/harmonized end state
 - Smaller industry participants may tend to favor harmonization as a means to reduce regulatory burden and compliance costs
- Meaningful harmonization will likely require substantial federal legislative intervention in an area where Congress has not always demonstrated understanding or finesse
 - Be careful what you wish for – Dodd-Frank Section 1073 (remittance transfers)
 - Industry-drive success stories exist (e.g., Check 21) but only with the confluence of unified industry support and significant environmental contributors
- Expect some harmonization efforts from the CFPB, but on a smaller scale
 - Product harmonization – Regulation E likely to be extended to general-use reloadable prepaid cards
 - Participant harmonization – Level playing field between bank and non-bank payment services providers