

# Nonbanks' Role in the Provision of U.S. Retail Payment Services

**European Central Bank**  
September 5, 2006

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# Nonbanks in the Payments System

- Nonbanks have always been a key component of the U.S. payments system
- Nonbanks have enhanced competitiveness and efficiency
- What is new is the heightened prominence and visibility of nonbanks

# Kansas City Fed Studies

- Bradford, Davies, Weiner, "Nonbanks in the Payments System," November 2003
- Sullivan, "The Supervisory Framework Surrounding Nonbank Participation in the U.S. Retail Payment System: An Overview," April 2006

# “Nonbanks in the Payments System”

- Key findings of the study
  - Nonbanks are pervasive
  - Nonbank business relationships with other participants are complex and intertwined
  - Nonbanks are rarely directly involved in settlement activities
  - Both nonbanks and banks are increasingly susceptible to operational risk

# What is a Nonbank?

- In this study, a nonbank is defined as any firm that is not a bank, where a “bank” is an institution that accepts demand deposits
- Can be owned or governed by bank

# Nonbank Payments Activities

**Table 1 – Nonbank Payment Activities**

Activity	Description	Representative Nonbanks
<b>AUTHORIZATION</b>		
<b>Check Authorization Vendors</b>	Supply check authorization and guarantee services to merchants.	eFunds, TeleCheck
<b>Fraud System Vendors</b>	Provide fraud detection services to merchants and financial institutions.	Thomson Financial, Bridger Systems
<b>Online Transaction Security Systems</b>	Provide online transaction security systems to merchants and financial institutions.	Baltimore
<b>Certificate Authorities</b>	Provide certificate-authority services in PKI-based secure environment.	Verisign, iTrust, Identrus
<b>Authorization ISOs</b>	Provide check verification and credit and debit card authorization services to small and medium-sized businesses.	Heartland Payment Systems, CardService International
<b>PROCESSING</b>		
<b>Hardware Providers</b>	Provide ATM and POS terminals, plastic cards, etc.	Diebold, Hypercom, NCR, Orbethur
<b>Software Providers</b>	Provide banking software.	Fiserv, S1
<b>Core Data Processors</b>	Provide processing for demand deposit account and core systems.	Fiserv, Alltel, Jack Henry
<b>Check Outsourcers</b>	Provide internal check processing services to financial institutions.	Fiserv, EDS, Metavante
<b>In-house Remittance Processors</b>	Billers and other corporates that perform their own remittance (lockbox) processing.	GE Capital, American Express, State Farm
<b>Remittance/Lockbox Processors</b>	Provide remittance (lockbox) processing to corporates and some areas of financial institutions, e.g., credit card bill payments, loan payments.	Regulus, Remitco
<b>Check Clearinghouses</b>	Provide check clearing and settlement services to financial institutions.	WesPay, NYCH/SVPCo
<b>Archive Services</b>	Provide payment-related archive and retrieval services.	ViewPointe
<b>Payroll Service Providers</b>	Provide payroll and related tax services to private and public sector employers.	ADP, Ceridian, PayChex
<b>ACH Outsourcers</b>	Provide internal ACH processing for financial institutions.	Fiserv, EDS, Metavante, Checkfree
<b>ACH Operators</b>	Provide central clearing functions (receipt, editing, and transmission) for ACH network participants.	EPN, Visa
<b>Card Issuer Processors</b>	Provide processing services to general purpose card issuers, including the issuing of statement, receipt, and deposit of payments.	First Data, Total Systems

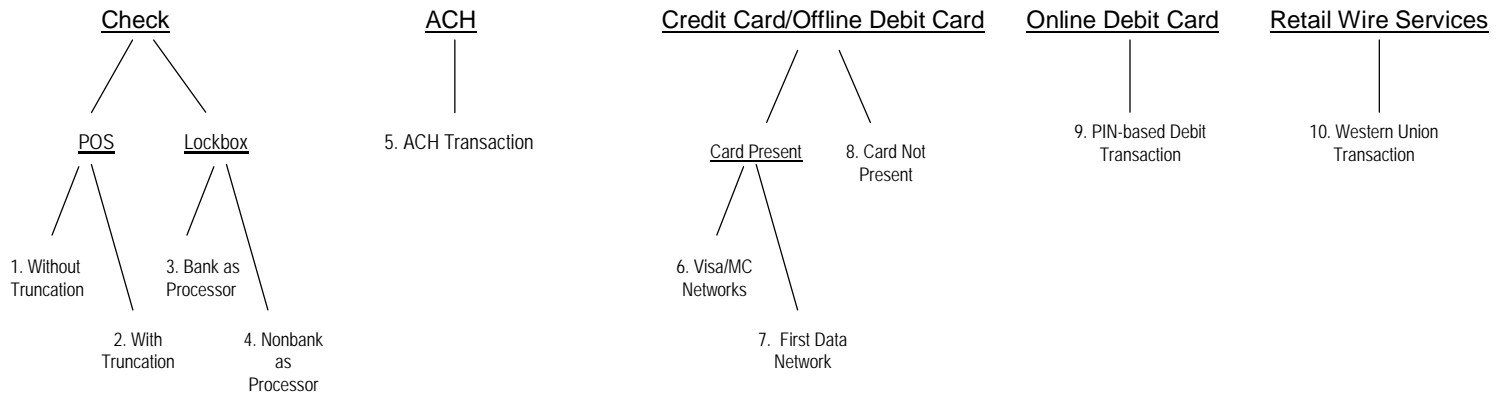
# Nonbank Payments Activities

**Table 1 (Cont'd) – Nonbank Payment Activities**

Activity	Description	Representative Nonbanks
<b>Card Merchant Processors</b>	Provide merchant processing services to financial institutions and merchants.	First Data, Concord
<b>Credit Card Networks</b>	Provide networks for clearing and settlement of credit card transactions.	Visa, MasterCard, American Express
<b>EFT Networks</b>	Provide networks for clearing and settlement of ATM and debit card transactions.	Concord/Star, First Data/NYCE, Visa, MasterCard
<b>ATM ISOs</b>	Provide ATM services such as sales, leasing, and management, typically to nonbank organizations.	eFunds, E*Trade, American Express
<b>EBT Service Providers</b>	Manage the distribution and tracking of EBT funds to recipients.	eFunds, Lockheed Martin
<b>EDI VANS</b>	Provide network and software to effect EDI payments and document exchange between large corporates.	Sterling Commerce, Harbringer Corp
<b>EIPP Service Providers</b>	Provide network and security services for business-to-business payments.	Bottomline
<b>Internet Banking Platform Providers</b>	Host Web banking platforms for financial institutions.	Digital Insight, Metavante
<b>EBPP Service Providers</b>	Provide bill payment services for consumers and presentment and payment receipt services for billers.	Checkfree, Metavante, Princeton eCom
<b>P2P Internet Payment Providers</b>	Provide payment solutions for online person-to-person payments.	PayPal, Western Union
<b>Retail Wire Services</b>	Provide money transfer (money wire) services to consumers.	Western Union, MoneyGram
<b>Check Cashing Services</b>	Provide check cashing services.	ACE Cash Express, Pay O Matic
<b>INSTRUMENT PROVISION</b>		
<b>General Purpose Credit Card Issuers</b>	Issue general purpose credit cards or charge cards.	American Express, Discover, Diners Club
<b>Private Label Credit Card Issuers</b>	Merchants offering store credit cards and third parties that provide card issuing services to merchants.	Sears, Chevron, GE Capital
<b>Debit Card Issuers</b>	Issue debit cards to consumers for retail purchases and fleet debit cards to companies for retail purchases.	Exxon, Mobil
<b>Stored-Value Card Issuers</b>	Issue stored-value cards for closed or open systems.	Stored Value Systems
<b>Money Orders</b>	Issue money orders.	United States Postal Service, Travelers' Express
<b>Travelers Checks</b>	Issue travelers checks.	American Express, MasterCard/Cook, Visa

# Nonbank Roles in Traditional Payments

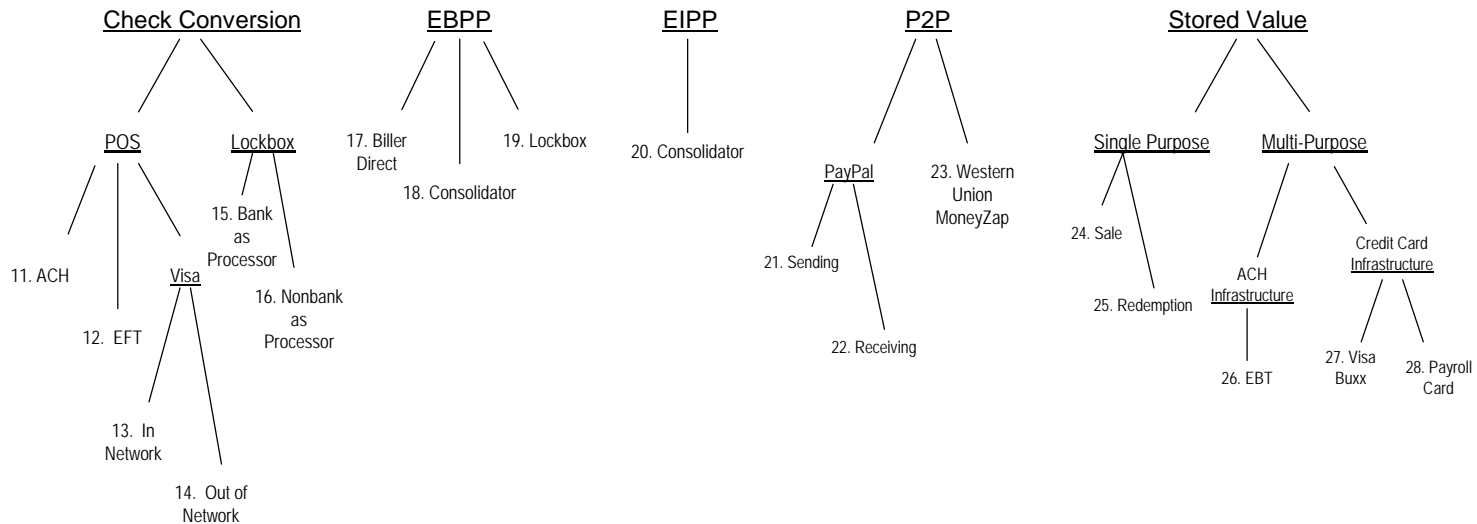
**Chart 1**  
**Nonbank Roles in Traditional Payments**





# Nonbank Roles in Emerging Payments

**Chart 2**  
**Nonbank Roles in Emerging Payments**



# Recent Nonbank Developments

- Major retailers attempting to move into banking for payments processing purposes, e.g., Wal-Mart, Home Depot
- Third-party service providers extending their reach globally, e.g., First Data Corporation, TSYS
- Change in organizational structure of nonbank card networks, e.g., MasterCard, Visa

# Recent Nonbank Developments

- Nonbanks acquiring EFT networks, e.g., Discover (Pulse), Metavante (NYCE)
- Merchants attempting to gain more control over payments environment via litigation, legislation, and adoption of alternative payment mechanisms, e.g., steering toward PIN debit, acceptance of Debitman
- Data breaches

# Observations

- Nonbank issues are showing up on more radar screens
- There is a growing awareness of rising nonbank presence and an increased concern about possible associated operational and System-wide risks
- Consequently, there is a heightened focus on supervision of nonbank providers of payment services

# "The Supervisory Framework ..."

- Key findings of the study
  - Increase in nonbank payments providers tied to increase in electronic payments
  - Potential for greater operational and System-wide risk
  - Many, but not all, major nonbank payments providers are supervised
  - Control of payments system risk should place more emphasis on interrelationships between participants

# Authority for Nonbank Supervision

- Bank Service Company Act (1963)
  - Supervisors can examine bank-related services provided by nonbanks
  - Applies to both bank-affiliated and nonbank-affiliated service providers
    - Supervised service providers are treated similarly whether bank affiliated or not

# Supervision of Nonbank Payment Providers

- Federal Financial Institutions Examination Council (FFIEC)
- Supervision is conducted jointly among federal agencies (OCC, FRS, FDIC, OTS, NCUA)
- Jointly, these agencies develop supervisory standards, examination policy, and examiner training programs
- Benefits of this coordinated effort
  - Reduction of regulatory burden
  - Improved use of examination resources

# Two Examination and Monitoring Programs

- Multi-regional Data Processing Servicer program (MDPS)
  - National program administered by the FFIEC
  - About 17 nonbank service providers
- Regional Data Processing Servicer program (RDPS)
  - Administered by regional and district offices of FFIEC agencies
  - About 150 nonbank service providers



# Recent Operational Risk Incidents

- April 2004: Two-day crash of U.S. Central Credit Union's network for handling ACH transactions delayed transactions for as many as four days
- March 2004: First Data Corporation overcharged 800,000 credit and debit card transactions to accounts of Wal-Mart customers

# Recent Data Breach Incidents

- February, August 2006: Two incidents of breached debit cards, including PIN numbers, from U.S. retailers that resulted in numerous unauthorized ATM withdrawals and many financial institutions reissuing debit cards
- February 2004: ChoicePoint data broker revealed information on 145,000 consumers to sham businesses that resulted in over 750 incidents of identity theft

# Observations

- Whether current regulatory framework is adequate depends on factors that are presently insufficiently documented
  - Nature of operational risk and sharing of information
  - Frequency of payments disruptions occurring at vendors outside current supervision program
  - Effect of concentration on "System-wide" risk

# Closing Remarks

- Nonbanks have always been a key component of the U.S. payments system
- The importance of nonbanks in the payments system is likely to increase even more over time
- Heightened visibility of nonbanks raises significant questions and it is important that policymakers continue to monitor and study industry developments

# Next Steps

- Joint ECB-Kansas City Fed project
- Kansas City Fed Conference
  - “Nonbanks in the Payments System: Innovation, Competition, and Risk”
  - Santa Fe, New Mexico, USA
  - May 2-4, 2007

# Contact Information

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