

Progress on the Path of Payments Improvement: Update from the Federal Reserve

Presented by

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Today's Learning Objectives

- ❑ Enhance your understanding of the Federal Reserve's faster payments efforts

Discuss the results of industry work group efforts and the current state of the Fed's settlement assessment

- ❑ Learn how a recommended fraud classification model and adoption roadmap could lead to improved fraud mitigation, easier collaboration for data sharing for fraud mitigation, and reduced fraud losses.

Discuss the Fed's Fraud Definitions Work Group and the progress they have made to help industry challenges stemming from inconsistent fraud classification and lags in reporting

- ❑ Hear about the challenges the industry faces in detecting and mitigating synthetic identity payments fraud, and what the Fed is doing to collaboratively reduce this fraud over time.

Discuss the Fed's efforts to educate, research and spark payments industry dialogue on synthetic identity payments fraud, and the next steps in this initiative



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Before we Dive In...Bring it Back to the Beginning

Strategies for Improving the U.S. Payment System Desired Outcomes



**Ubiquitous, safe,
faster electronic
solution(s)**



**Strong and
responsive payment
system security**



**Payments originated
and received
electronically**



**Better choices for
cross-border payments**



**Payment system
improvements are
collectively identified
and embraced**



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Desired Outcome: Speed

A ubiquitous, safe, faster electronic solution(s) for making a broad variety of business and personal payments supported by a flexible and cost-effective means for payment clearing and settlement groups to settle their positions rapidly and with finality.



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Faster Payments Task Force Final Report Recommendations

Governance and Regulation

- **1. ESTABLISH:** Governance framework
- **2. RECOMMEND AND ESTABLISH:** Rules, standards, and baseline requirements
- **3. ASSESS AND RECOMMEND:** Assess payments regulatory landscape and framework and recommend changes

Infrastructure

- **4. ESTABLISH:** Inclusive directory work group
- **5. ENHANCE:** Federal Reserve settlement mechanisms
- **6. EXPLORE AND ASSESS:** Need for Federal Reserve operational role(s)

Sustainability and Evolution

- **7. RECOMMEND, DEVELOP AND IMPLEMENT:** Methods for fraud detection, reporting, and information sharing
- **8. DEVELOP:** Cross-solution education/advocacy programs
- **9. CONDUCT:** Research/analysis to address gaps in cross-border functionality and interoperability
- **10. CONTINUE:** Research/analysis on emerging technologies



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Resulting Efforts – Governance & Regulation

Governance Framework Formation Team

- Worked to develop a governance framework for faster payments in the United States, and establish that framework and membership
- Established the U.S. Faster Payments Council at the end of 2018

Rules, Standards, Laws and Regulations Work Group

- Worked to identify and complete necessary groundwork on benchmarking existing rules sets and prioritizing areas of laws and regulations.
- Finalizing their findings to share with the FPC



Resulting Efforts – Infrastructure

Directories Work Group

- Worked to identify and complete necessary groundwork in pursuit of a directory design for solutions to interoperate in the faster payments system.
- Provided their findings to the FPC

Federal Reserve Settlement Assessment

- Assessed a range of potential services that the Fed could develop/implement to support broad industry adoption of faster payments.
- Engaged with the industry to understand current faster payment systems



Federal Register Notice: Potential Fed Actions to Support Faster Payments

As part of the Federal Reserve's settlement assessment the Board of Governors released a Federal Register Notice on October 3, 2018



Purpose of the Federal Register Notice:

- Present potential actions the Fed could take to further industry goals of ubiquitous access to safe and efficient faster payments
- Seek public comments on which, if any, of these actions the Fed should pursue further



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Federal Register Notice: Potential Fed Actions to Support Faster Payments

Objective: Promotion of ubiquitous, safe, and efficient faster payments in the United States through facilitation of real-time interbank settlement

Two potential Fed actions:

1. Develop a **24x7x365 RTGS Settlement Service** for faster payments
2. Develop a **Liquidity Management Tool** to support RTGS services



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Federal Register Notice Responses & Next Steps

- Broad engagement generated over 400 comments and 300 form letters from industry stakeholders across multiple segments. These comments will inform the analysis to determine Fed actions.
- Any new service to be offered by the Fed must be consistent with the guidelines outlined in “The Federal Reserve in the Payments System” developed in 1984



- Expectation of **full cost recovery** over the long term
- Expectation of a **clear public benefit**
- Other providers alone** cannot be expected to provide the service with reasonable efficiency, scope, and equity



View all +700 responses and form letters on the Board's [website](#)





Desired Outcome: Security

U.S. payment system security that remains very strong, with public confidence that remains high, and protections and incident response that keeps pace with the rapidly evolving and expanding threat environment.



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The Federal Reserve's Current View of Payments Fraud

Federal Reserve Payments Study: *Changes in U.S. Payments Fraud from 2012 to 2016*

- Changes in non-cash payments
- Does not include information about fraud causes and contributing factors

Boston Consulting Group secondary research and supplemental interviews

- Assess fraud and associated costs
- Identify gaps in existing data
- Identify fraud causes and contributing factors



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Boston Consulting Group: Secondary Research

- **Boston Consulting Group reviewed about 50 previous studies, including:**
 - Federal Reserve Payments Study: 2017 Annual Supplement, 2016 and 2013 studies
 - ABA Deposit Account Fraud Survey 2017 (*check and ACH/wire*)
 - AFP Payments Fraud and Control Survey 2017 (*check/ACH/wire/corporate card*)
 - FRB Board of Governors Covered Issuer Study (*debit issuers, merchants, cardholders*)
 - Pulse Debit Issuers Report (*debit card issuers*)
 - First Annapolis Issuer Fraud Study (*credit and debit issuers*)
 - Javelin Card Fraud Trends (*credit and debit issuers*)
 - FRB Kansas City Chargeback Study 2016 (*merchants*)
 - FRB Minneapolis 2014 Payments Fraud Survey
 - Nilson (*credit card issuers*)
 - CyberSource (*e-commerce*)
 - LexisNexis (*merchants*)



In scope:

- Unauthorized third-party fraud

Out of scope:

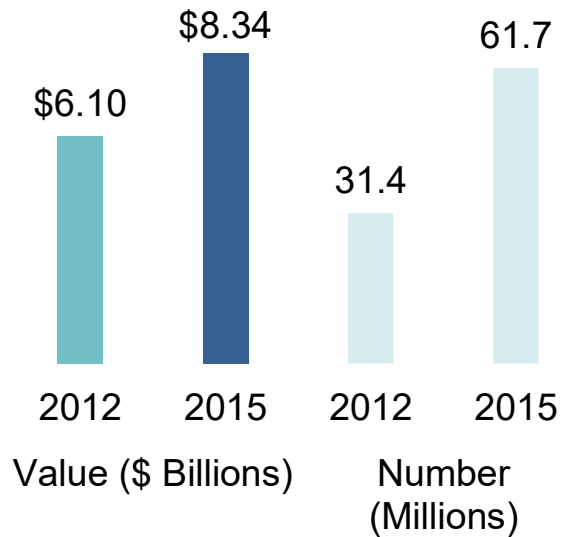
- First-party fraud
- Friendly or familiar fraud
- Victim-assisted fraud (e.g., authorized payment scams, social engineering, business email compromise)

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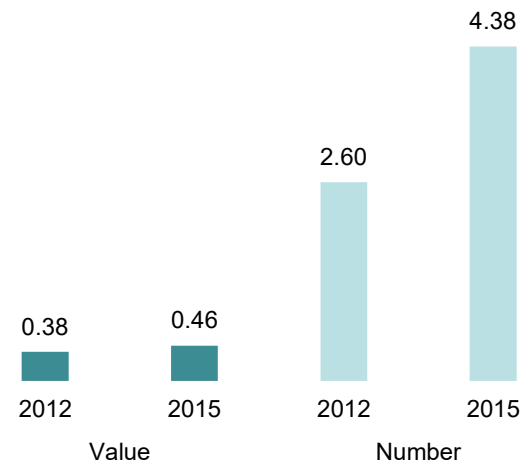
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The Value of Payments Fraud Grew Faster Than the Value of Total Payments 2012 to 2015

Total Payments Fraud
(non-cash, non-wire)



Payments Fraud Rates
(basis points)



Fraudulent payments are a small fraction of payments value:

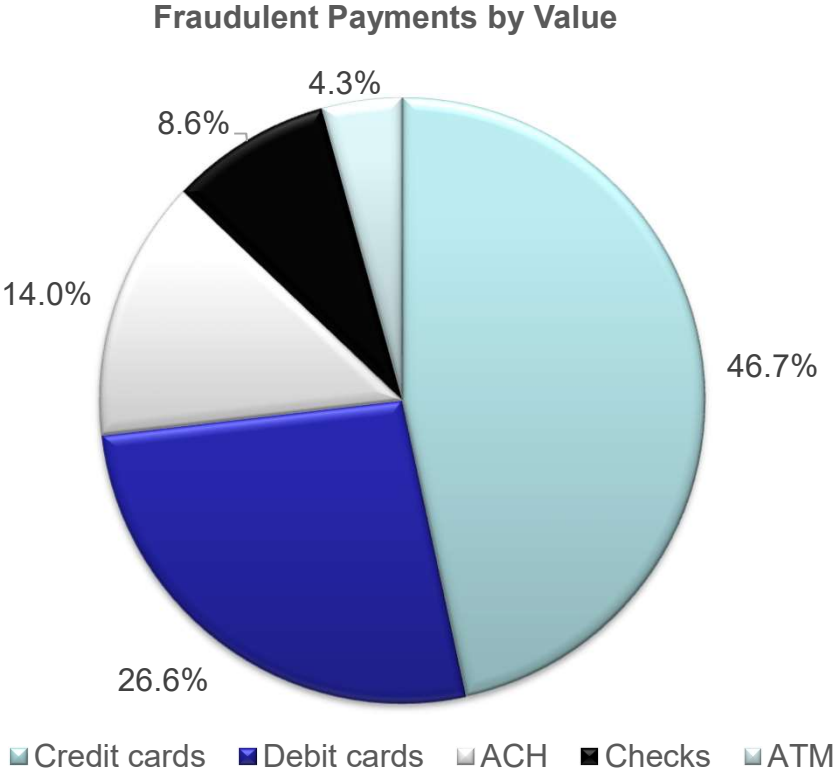
- 46¢ for every \$10,000 in payments in 2015
- Less than 1/200 of 1% of all non-cash payments by value



A basis point is 1/100 of 1 percent. Source: Federal Reserve Payments Study – 2012 and 2015 depository institution surveys



2015 Fraud Data by Payment Method



Source: Federal Reserve Payments Study – 2012 and 2015 depository institution surveys



The Federal Reserve's Proposed Work Efforts

Identified by Secure Payments Task Force

Affirmed by Research

Refined Through Industry Engagement and Dialogue

- **ACH, Wire and Check Fraud Definitions:** create and publish recommended fraud definitions; develop a roadmap to encourage broad industry acceptance and use of these definitions in fraud reporting
- **Synthetic Identity Fraud Mitigation:** increase understanding of system vulnerabilities that allow the creation and use of synthetic identities to perpetrate fraud; partner with industry stakeholders to identify/advance approaches to mitigate synthetic identity risk and prevent fraud
- **Remote Payments Fraud Mitigation:** mitigate remote payments fraud and strengthen endpoint security; encourage adoption of effective approaches to secure digital identities and improve authentication of remote payments transactions
- **Facilitate Strategic Dialogue on an Evolving Payments Security and Fraud Issues:** improve understanding of emerging fraud vulnerabilities, threats and risk management opportunities through dialogue across the industry in existing industry work groups and information sharing forums



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ACH, Wire and Check Fraud Definitions



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Fraud Definitions Overview

INDUSTRY CHALLENGE

- Inconsistent availability and classification of payments fraud data limits the effective, efficient, and timely cross-industry sharing of fraud patterns, trends, and losses; a contributing factor to missed fraud mitigation opportunities**

OPPORTUNITY

- Improve fraud data consistency**
- Optimize communication across the industry**
- Focus initial effort on ACH, wire and check fraud taxonomy**

OVERALL STRATEGY

- Collaborate with industry, to develop a payments fraud classification model that enables consistent communication and sharing of fraud information**
- Establish a Fed-led work group composed of FRS and industry representatives**
- Develop and promote an adoption roadmap to raise awareness and encourage use of newly developed fraud classification model**
- Advance work in incremental phases while proactively and transparently communicating status and expectations to the broader payments industry**



Fraud Definitions Work Group

A greater understanding of payment system fraud trends is essential for mitigating risk. The Federal Reserve sees value in evolving towards a more consistent and holistic U.S. fraud perspective through a collaborative approach with industry professionals.



In its pursuit of this objective, the Fed is establishing and leading a Fraud Definitions Work Group that will:

- Bring together expertise and diversity of thought;
- Develop a fraud classification model to help the industry more quickly identify fraud trends in ACH, wire and check transactions and;
- Propose a roadmap to encourage broad industry adoption of its recommended model

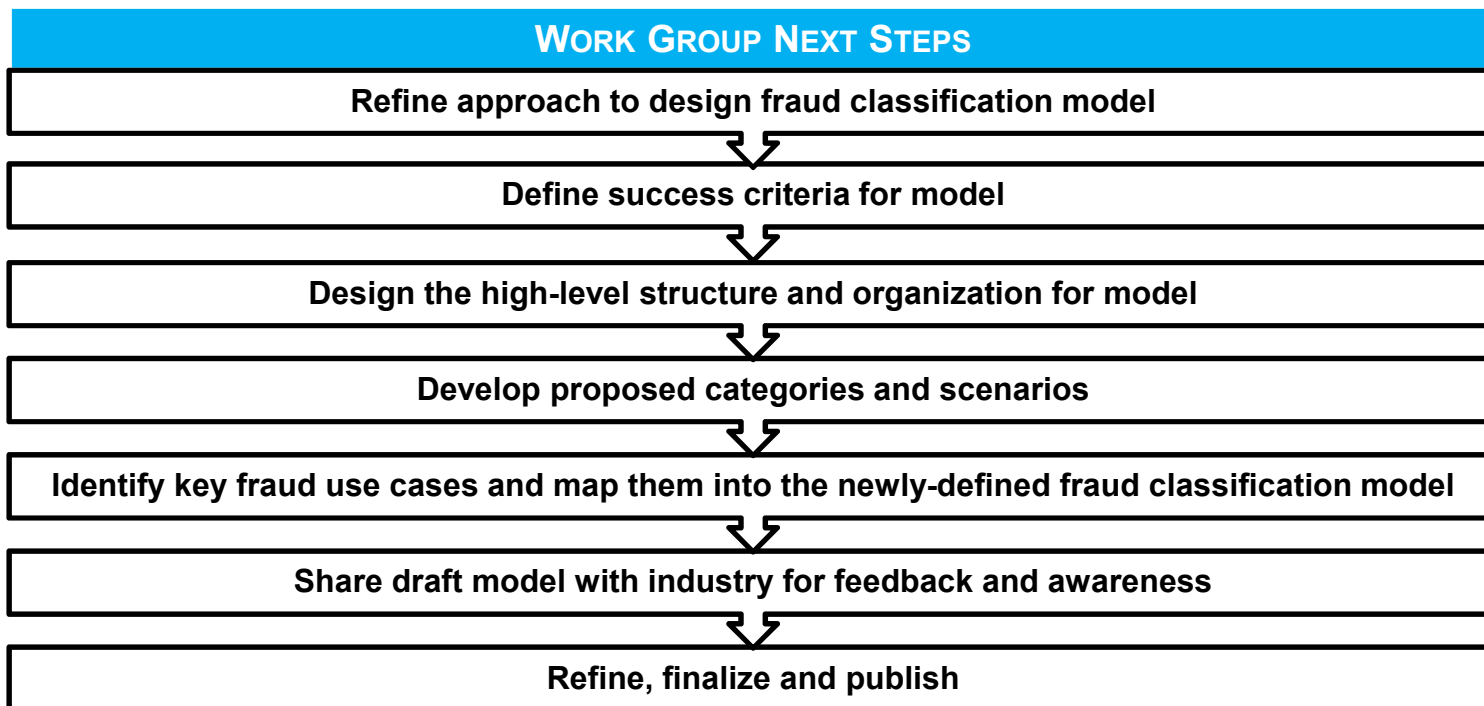


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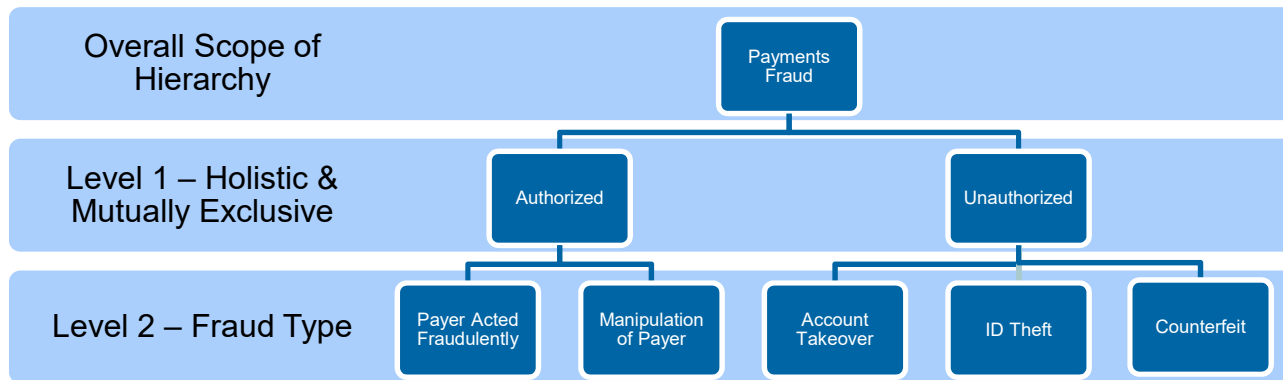
Fraud Classification Model

An expandable structure that enables mapping of multiple and varied definitions into consistent, higher-level business terms for use by industry to more effectively communicate fraudulent activity and trends



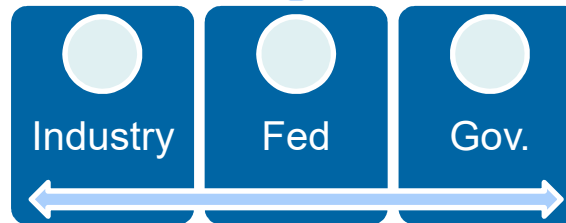
Desired Outcome

Vision for a Consistent Payments Fraud Classification Model



ILLUSTRATIVE

Aggregate Fraud Profiles Information



Planning for Industry Adoption

Developing both a strategy and approach that promotes industry acceptance and use of the new payments fraud classification model for ACH, wire and check

KEY ACTIVITIES

Determine possible uses and adoption targets for fraud classification model



Develop strategy and approach for promoting industry acceptance and use



Seek feedback, support and commitment from industry at select stages of the roadmap development



Share draft adoption roadmap with industry for feedback and awareness



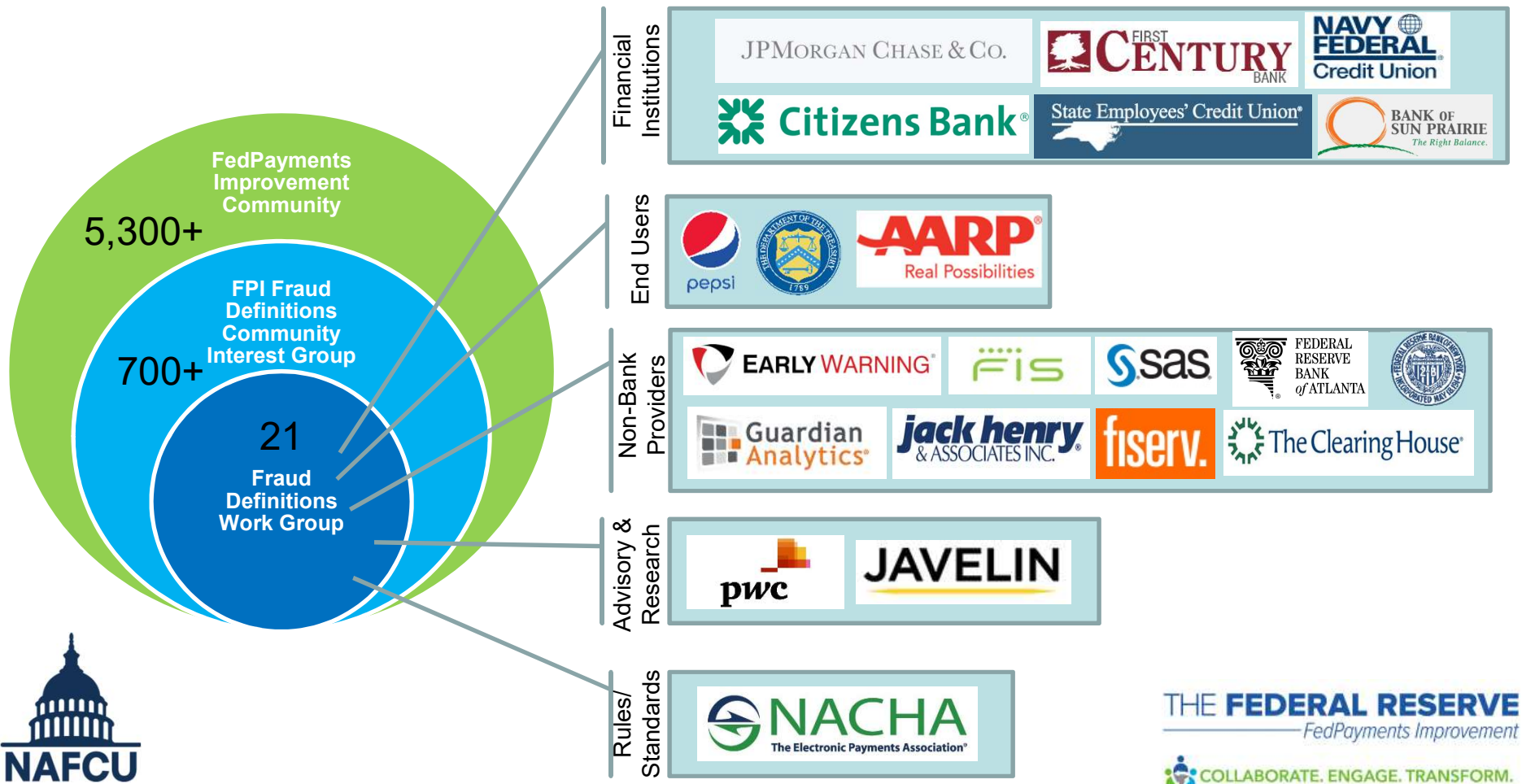
Refine and publish roadmap and next steps



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Broad Stakeholder Engagement Will Inform Work Effort



FedPayments Improvement Fraud Definitions Community Interest Group

This group will have the opportunity to:



Participate in input and feedback opportunities throughout the work group effort



Obtain regular updates on work group progress



Meet with Fed SMEs and/or work group members via teleconferences

Join the Fraud Definitions Community Interest Group by submitting or updating your [FedPayments Improvement Community](#) profile and selecting “ACH, Wire and Check Fraud Definitions” as a topic of interest.



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Synthetic Identity Fraud Mitigation



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Synthetic Identity Payments Fraud

INDUSTRY CHALLENGE

- Synthetic identity payments fraud is a **combination of real information** (e.g., a legitimate Social Security number) **with fictional information** to create an identity used to defraud or evade payments safeguards.

OPPORTUNITY

- **Foster dialogue to improve industry understanding** of synthetic identity fraud in the U.S. payment system, including the scope of the issue and current mitigation strategies.
- **Desired outcome:** the industry works collaboratively to understand the issue – and to reduce synthetic identity payments fraud and related risks in the payments ecosystem.

OVERALL STRATEGY

- The FRS will focus on **analysis and dialogue** on the current state of synthetic identities and related payments fraud
- **Share information and identify opportunities** for further collaboration since synthetic identities are far-reaching, impacting financial and non-financial institutions.



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Dialogue & Communications Opportunities

Industry dialogue opportunities to include:

- Industry roundtable(s) and in-person meetings
- Webinar(s) featuring subject matter experts
- Discussion of key findings in FRS white papers

Q2 - Executive Summary

Synthetic Identity
Payments Fraud
Overview

Q2 - White Paper
Deep Dive
Causes and
Contributing Factors

Q3 - White Paper
Current State
Detection, Controls
& Gaps

Q1 20 - White Paper
Future State
Potential Mitigation
Approaches & Best
Practices



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Conclusion



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Ways to Engage with Us!



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