Paradigms Lost
The Art of Managing Payments in the 21st Century

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1. With apologies to John Milton
Lessons From Literature

• Milton’s epic poem, *Paradise Lost*, dramatized the Biblical theme of the Fall of Man

• His 1667 work was comprised of 10 books and 10,000 lines of verse

• And featured Satan and his minions as the key players in the battle for heaven and earth

• Focus on Paradise in the Garden of Eden

First Edition, 1668
Payments Paradise-the 20th Century
Depending on Your View

• Well established, bank centric methods of payment
• Gradual pace of innovation and change
• Extended usefulness of payments technology
• Healthy, but manageable competition
• Limited engagement of government in payments regulation
• Constant volume growth in all payments methods and generally favorable economic conditions
• Passive, reasonably non-demanding customers
• Highly domestic payments world
Paradise Lost -the 21st Century

Depending on Your View

- Emergence of aggressive non-bank players
- Explosive pace of innovation and change
- More rapid technology turns
- Intensive competition from old and new sources
- Increased government regulatory intervention
- Declining or stable volume in traditional payments and depressed economic conditions
- More outspoken customers and changing demographics
- Rapid globalization of payments
At the Core of the New Paradigm

Changing Payment Volumes

• Impressive declines in check payments
• After years of double digit growth, ACH volume tables in 2009/2010
• Credit usage levels off after steady growth
• Explosive growth in debit usage continues unabated
And Many Candidates for Satan

* Depending on Your View *

Gustav Dore’, 1866
The Paradigms of Payments Paradise

• Provide the customer new products they should like and minimize education
• Minimize disruption, foster incremental change
• Compete largely on price/service level
• Rely on your own world view and resources
• Engage in long planning and execution cycles
• Buy more for the future
• Focus domestically

Jan Brueghel, 1620
New Paradigms Of Payments

Pandemonium

• Stay very, very close to the customer and inform them
• Sponsor innovation and disruptive change
• Compete on technology and new ideas
• Explore collaborative opportunities
• Develop flexible strategic plans with modest windows
• Buy only when needed; depreciate rapidly
• Compete globally

Gustav Dore’, 1866
On The (Long?) Horns Of The Dilemma

Managing Payments Technology Today

Duration of Technology Turns

Time to Implement New Technology

Time to Depreciate Investments
A Case in Point?

**Managing Point of Sale Technology**

- Magnetic Stripe
- Contact Chip and Pin
- Contactless Chip and Pin
- Mobile NFC

From the Merchant/Issuing Bank’s Eyes
Finding the Way Forward

New Rules for a New World

• Rule 1: The old rules don’t work

• Rule 2: Get much closer to the marketplace

• Rule 3: Strategic planning is a must...every year!

• Rule 4: Innovation is a necessary ingredient

• Rule 5: Aggressively manage the bottom line

• Rule 6: Explore partnerships to accelerate progress
Rule 1: The Old Rules Don’t Work

• New factors like the Internet, mobility, globility, and demography have changed the game
• In combination with tough economic times
• And new regulatory landscapes
• And complete transparency in an interconnected world
Rule 2: Get Much Closer to the Customer and the Marketplace

- Don’t take anything for granted
- Overconfidence has serious repercussions
- Market intelligence is at a premium
- Survey work can shape products and services—emphasize value added services
- Competition is virile in a worldwide market
Rule 3: Strategic Planning is a Must...Every Year!

• Try a five year vision
• With a three year plan
• And an annual review
• And serious, honest scenario planning
• Involving more of your leadership team
• Remember: “Some planning is better than no planning all the time”

Auguste Rodin, 1902
Rule 4: Innovation is a Necessary Ingredient

- Innovation is a must to survive!
- May involve a difficult **culture** change
- But must be done thoughtfully
- And rewarded when successful
- And may involve partnerships and strange bedfellows
Innovation and Culture Change

"I'll be happy to give you innovative thinking. What are the guidelines?"
Rule 5: *Aggressively* Manage the Bottom Line

- Tried and true and tough
- Avoid compounding debt
- Eliminate silos wherever possible
- Do better business case analysis
- Invest in incentives to meet or exceed targets
- Outsourcing is a potential answer

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Federal Reserve Check Costs and Revenues (2003-2010)
Rule 6: Explore Partnerships to Accelerate Progress

• Skill specialization and lean budgets hamper independent efforts
• Successful products must satisfy users across multiple dimensions
• Shared resources improve economies of scale
• Speed to market is enhanced
• But... must balance against later flexibility
A Case in Point?
The Mobile Payment Evolution

- Growing widespread appreciation for the market potential of the smart phone, but penetration still modest (Rule 2)
- Innovation flowing from virtually all ecosystem players in the form of feature announcements and pilots (Rule 4)
- With lots of concern about the cost and revenue aspects of the bottom line absent ubiquity (Rule 5)
- But, no real roadmap and no effective venue for collaboration and agreement on key issues, in essence misuse of the term “ecosystem” (Rule 3, Rule 6)
- An effort to gain momentum through the Fed sponsored Mobile Payments Industry Workgroup. See white paper at http://www.frbatlanta.org/rprf/ or http://www.bostonfed.org/economic/cprc/index.htm
Foundation Elements of a Successful U.S. Mobile Framework

• An open mobile “wallet” that supports multiple payment credentials in a secure container
• Implemented using contactless NFC technology and enabling phone apps
• Clearing and settlement over existing rails (credit, debit, prepaid, ACH) with openness to any future new channel
• Use of dynamic data authorization for integrity and security
• Based on evolving global standards and an industry supported certification process
Foundation Elements of a Successful U.S. Mobile Framework

• Clear delineation of ongoing *regulatory oversight* responsibilities
• Presence of *Trusted Service Managers (TSMs)* to provision the secure elements in the phone
• Potential future need for a *collaborative, neutral industry forum* to address issues of common concern and importance (standards, business rules, security challenges, etc.)
• MPIW did not concur with a short term effort to construct and *industry roadmap* for going forward
Paradigms Found

The Rationalization of Payments

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Concluding Thoughts

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“Chaos is a friend of mine.”
- Bob Dylan, 1985