THE BROOKINGS INSTITUTION

WEBINAR

# HOW TO MAKE REAL-TIME PAYMENTS REAL NOW

Washington, D.C.

Tuesday, September 22, 2020

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P R O C E E D I N G S

MR. KLEIN: Welcome. My name's Aaron Klein. I'm the director for the Center on Regulation and Markets, and a fellow at the Brookings Institution. I'm joined here today with an expert panel. Let me introduce them real quick as we get started, and maybe they will unmute themselves.

Peter Conti-Brown, a professor at the Wharton School at the University of Pennsylvania. Nakita Cuttino, a professor at Duke University Law School. And George Selgin, fellow think tanker with a big title and a big job at The Cato Institute. George, Nakita, Peter, welcome.

MR. SELGIN: Nice to be here.

MR. KLEIN: Good, everybody unmuted. I want to start by pointing out that today is September 22, and six months ago Congress passed the CARES Act. It did so really fast because we had a giant crisis known as COVID that we're still living in. Hence, we're all zooming this dialogue together on screen, and folks are joining in. Hopefully on Twitter you can hashtag ask questions at fix payments.

But I want to jump right in because life got real when COVID started in March. The entire economy shut down, unemployment skyrocketed to levels not seen since the 1930s. What I lived through the great financial crisis seems quaint when you look at the data now.

The government had to get money to people in an emergency. Life and death, no one was working, kids were hungry, and we responded. Pretty big package. Trillions of dollars. $1,200 were coming to everybody. That money passed into law took weeks to be sent. When it was finally sent to a select few the Treasury could access their information, it was sent on Good Friday of Easter weekend. It showed up in their accounts the following Wednesday.

How did people live through Easter weekend? Well, we know that one in four, one in five children are hungry. That mothers are reporting not having enough money to feed them. Right. Where are some of the problems here? There's a core problem our society has not addressed for decades, and it's an arcane thing called our nation's payment system. The consequences of the failure to address real-time payments can be seen in the billions of dollars a year spent by low income people on check cashers, money transmitters, payday lenders. But it can be acutely felt by all Americans who had to wait weeks and months to get emergency aid during the height of an economic crisis.

And so the reason we've come here together today is to discuss how we can fix this. Right. The days of pretending like our payment system are fine are over. Nobody no longer says that because we have a system that works for the elite. The poor and working-class people just have to deal with the delay and financially educate themselves out of it, waiting days for their money. We also have a legal and regulatory system that's slow to react, and we have a group of people who have been thinking about this issue for years.

So let me start. And I'm going to start by asking you guys to solve the problem. And I'm going to give everybody here this great luxury that we will never have in life which is that you're queen or king. You control The Fed, The Treasury, all of the bank regulators. What can you do? Whatever date it is, imagine January 21. What can you do to fix this problem? Can you fix it yourself? Do you need new legal authority? Do you need to build something new? What can you do?

Before putting my panelists on the spot, I'm going to tell you what I would do. I would take the Federal Reserve's authority under the Electronic Funds' Availability Act passed in the 1980s by Congress when there was this new technology called desktop computers. And the Fed has this legal authority and has been sitting on it for decades to require everybody's money be made available immediately. They could flip that lever tomorrow if they wanted to by regulation EFA Section 402(b).

I would require all banks to offer customers what's called a safe account model on the FDIC safe account or the city bank access account. All banks would have to offer this, no offer draft fees, no minimum balance, no check book. I'm sorry, consumers, you don't get everything for free to cut off America's overdrafts. And I would require the Treasury Department to start building, operating, and maintaining a database pairing taxpayers and their bank accounts so that we don't have this giant information gap that plagued us before.

That's what I would do. I have no monopoly on all the solutions. So let me throw it up there. Somebody jump in. What would you do? You're in charge.

MR. CONTI-BROWN: I'd rather talk about why your ideas are terrible, but I don't have really good alternatives. So I don't know if that's in the spirit of your question.

MR. KLEIN: You can trash my ideas and question too.

MR. SELGIN: I have some thoughts. Can I jump in? So first thing I'd like to say is that we should not be talking exclusively about instant payments when we're thinking about how to solve this problem. Not that that's not an ultimate goal, but we should, first of all, talk about making payments faster which is not the same thing. The most serious delays in the payment system in the U.S. today, the kinds of delays therein you've described in the examples you were giving are not measured or minutes or even hours, but in days, multi-day delays from the time a payment is ordered, to the time where the final payment comes through where you actually have everything settled.

And the source of all greater than one day settlement payment lags is all in settlement. Everything else is pretty quick, actually, in our current system where everything's gone electronically. Partly thanks to your efforts, Aaron, thank you very much, with Check 21. And so the lag is in settlement which is the inter-bank settlement of accounts.

And so if I were to be king of the world, I would put my priority not on Fed Now which is going to take years to get started. I would be putting it on expanding the operating hours of the existing Fed settlement systems. That's where the delay comes in. And I know this sounds almost too simple, but the problem is they're closed on weekends and holidays. That's where the long delays come in.

Now, they also have limited daytime hours now, but they're finally getting around next March to adding enough time to their opening hours on business days to fit in a third payment window which they've been encouraged to do for years. They're finally going to do it next March.

Once that's done, if you add weekdays and holidays, all the legacy payments, checks, ACH, virtually all the payments that involve the banking system, none of them should take more than a few days to clear, to settle. In fact, they should all be one day, same day. Not instant, but same day.

And then, Aaron, if you were to put your rule into effect, it would be much better to do it in that case. Because the banks wouldn't face any settlement risk if they could clear -- they could release funds with a lot more safety instantly which they already do on Zelle, for example. But the risk would be a lot less because they'd settle that same day, so it's a much shorter delay between releasing funds to an account and getting it paid by the recipient's bank.

So that's what I would do. And it would solve, if I may just one more minute, it would solve more problems than just the problem of settlement lags, multi-day settlement lags. It would automatically create a liquidity management tool for all the fast payments, the instant payment services. Right now, the Fed's contemplating creating a new liquidity management facility just for Fed Now and for real time RTP, the real time payment system run by the clearing house. But that's a substitute for just having Fed wire and NSF open 24/7. It would reduce the system risk on Venmo, Square. All of those things have an initial payment, and they all settle in the long run Fed wire or NSS, so those would all be enhanced. All of those smaller network instant payment systems would be enhanced.

Finally, you would have so little difference between all of those payment service providers and RTP that the virtual competition that RTP would face would be very great. And the need for a second, expensive Fed operated real time network would not be so great. You could still make arguments for having that second set of rails, but let's face it, that won't come on for four years. All these other things could be done much more quickly, and the tragedy is they could have been done four years ago, maybe more. They've been talking about it since 2012.

MR. KLEIN: Well, England did it in 2008.

MR. SELGIN: Yes.

MR. KLEIN: Nakita, what do you?

MS. CUTTINO: Yes, so my thought goes more to the money itself because I think a number of these proposals, with the exception of yours, Aaron, and trying to make the banking system more inclusive. But it requires you to have a bank account to even get electronic payment. And so under my proposal if I was in my own world is something inspired by pre-paid debit cards, so to speak.

I would have, essentially, the Fed convert the U.S. dollar from paper to plastic. Think of it, I'll call it, like, the dollar card. It would be a bear instrument in and of itself. Transferable in physical form, but its value could be adjusted and transferred electronically as well. So we would have, as with pre-paid cards, transaction accounts that are limited to a fewer number of set master accounts. So instant payments could be facilitated between the cards themselves.

And since the master accounts use existing payment structures or infrastructure, the transfers between the dollar cards and even bank accounts could be facilitated via ACH, Fed Wire, or the promised Fed Now Network. And so the Fed wouldn't have a need for partnering with a costly credit card network, as say the Treasury did to issue stimulus benefits on pre-paid cards.

And so to have a dollar card or plastic money bypasses bank accounts altogether to offer open access to electronic payments. So in doing this, there's no heavy lift with converting government agencies as to public retail banks. There's no AML monitoring costs. There's no disruption to the idea of credit intermediation.

There's also no delay or interoperability issues as with tokenization proposals that seek to make the dollar boxing-based currency. So it's a quicker fix, I think, to the narrow issue of real-time payments. But it could be linked to these more ambitious proposals, to the extent we do want public banking or block-chain based or more innovative monetary system.

MR. KLEIN: Peter?

MR. CONTI-BROWN: So let me take the view as a Berkian (phonetic) and progressive. And what I mean by that is someone that is keenly aware that the problems that Aaron has described are profound. It's not that our status quo looks great and so we should be pleased with it. But I am very worried about moving fast and breaking things within the national payment environment. This makes me reluctant, for example, to endorse proposals like Postal Banking or Fed account from folks like Marissa Broderson or Lev Mendandon (phonetic) and Morgan Ricks.

I would be similarly a little bit troubled by a dollar car that were a bear instrument. I'd be worried about exploitation in that regard. But it's completely consistent with burkian progressivism to tell the Fed to turn its lights on 24 hours a day, as George has suggested. I think it's completely consistent with this view to have the Fed lean into not only its role as an operator which I'm much more sympathetic than George is. But also to recognize the Fed plays a profound role as a market participant in the clearance of payments as the fiscal agent of the government. It plays a profound role as a supervisor. Not only of banks and bank holding companies, but also of the very entities that run the plumbing of the payments' infrastructure.

Now, this is a supervisory authority that the Fed has largely disclaimed. Now, that's inconsistent with law. Not that the Fed has been required by Congress to exercise the supervisory authority, but has been permitted to do so, and it has said so far, we can't really, and this has one of the justification's it's offered for creating its own real-time payment rail. I think that's false.

And so I think that having the Fed -- now, you asked if I were king for the day what I would do, and my Burkian progressive answer is use the existing infrastructure we have, push it more to its greater limits. I don't think the legal authority you cited, Aaron, is the right path, but I think that idea is exactly correct. Use existing statutory authority the Fed has to encourage the innovation that we need to see real time payments from a variety of different pockets. So I'd want to see that kind of experimentation before launching into wholesale revolution in this space.

The only other thing I would add, this isn't to beg the question, but I think it's to recognize where this fits in the consultation of issues about inequality and access. And that is facilitating real-time payments will not resolve very profound issues of wealth and income inequality. And it's not going to solve the problem of the macroeconomic hole that has been blasted into the United States by the COVID-19 crisis.

And so one thing that I would do if I were king for the day, would be reauthorize many of the CARES Act's provisions, let the Treasury gain experience from its last round. And I'd look back and I would say, you know what, there were some flaws. There was some fraud. There was some delays. But let's look back and declare victory on what was victorious and try that again, and let real-time payments be the subsidiary issue that I think it should be in some of the very pressing questions that we're facing with this pandemic.

MR. KLEIN: So, Peter, I'm going to turn to your favorite part which is response to other folks' answers, and this is the ten days of awe in the Jewish calendar. Happy New Year to everybody, 5781. I think regardless of your faith, we can all agree that 2020, it's time to move on.

But there's a different prayer in Judaism called dayenu in which the thesis is to support incrementalism as progress without rejecting each step of incrementalism because it is not full salvation and deliverance. I concur completely with you the structural problems in the United States economy that have resulted in this great level of inequality in which the current COVID recession I'm becoming more believer that this is a K-shape recovery. The wealthy are doing well. The poor are going down. Real-time payments doesn't solve that. Never can, never will. It won't solve wage inequality. It won't raise the minimum wage. Blah, blah, blah, blah, blah.

Okay. What we can do is we can stop making it so expensive to be poor. The payment system has become an accelerant of inequality. We all get 2 percent cash back when we charge things on our AmEx. And as Nakita points out, when somebody tries to take cash and turn it into a digital pre-paid card so they can access the benefits of the on-line economy, they pay 3 percent to upload their cash in a gift card. One out of every ten swipes is a pre-paid card in America. I'm going to guess that less than 1 out of every 10 people watching this has a pre-paid card in their wallet, let alone uses it. Right. We have a totally separate payment system for the wealth and for the poor, and for the poor, it costs money, and for the rich it gives them money.

Billions of dollars a year. So when you say don't move fast and break things, there's a supposition in there that the payment system isn't broken, and it is. It isn't broken for banks who make $35 billion a year in overdraft. It isn't broken for the Fed whose HCH system operates. As George points out, the last time the Fed leaned in on this before Fed Now, and I think the Fed in the last few years, to give them credit, particularly Governor Brainard has done a remarkable pivot to start addressing some of these problems rather than just, you know, doing a Hamlet what to do. It was 9-11 when the payment system did break, only because they ground all the planes that were physically flying paper checks after, you know, Amazon had already reached $100 a share and crashed again.

The second sets of comments. I wanted to mentioned George's comment about settlement risk. I think this is grossly overblown in this context. Yes, in my theory the banks would have some settlement risk, or they could move from ACH to RTP. Even then there's a little bit of settlement risk, okay, we're only dealing with the first $5,000 of people that have been there six months or more. What did Citibank do on settlement on Revlon? $900 million of misspent funding, right. What happened with the Federal Reserve in the bank in Asia? Billions of dollars moved around.

I believe England's real-time payment system has a lower rate of fraud than the U.S. debit card system. I mean we're holding hostage low income people to some high level of settlement risk. Meanwhile, anybody can take a plastic card and write I'm committing fraud as they sign for their check and go right through the register.

In terms of the Fed plastic cards, that's kind of interesting, Nakita, in the sense that that can go really fast. And I really appreciate that you address AML costs because I do think there's a myth that postal banking means the post office doesn't have to, you know, known their customer and do AML. And that's just -- I mean, that's really expensive and I think people -- I mean, who would monitor the AML of these transactions? Somebody would have to. You could easily see how these cards could be used in a human traffic system. Somebody would have to monitor that. Maybe it comes from the Fed, but I challenge you on that.

So you guys tell me why you're right and I'm still wrong and who wants to respond.

MS. CUTTINO: So on the AML costs. There's certainly risk there, but I think it's more muted. In part because if this operates like cash, I don't know that the vast majority of people want just cards loosely. They'll want to link it to a bank account which, in my view, would be safekeeping of your funds. It's like carrying thousands of dollars in cash around or leaving it at your house. Like, people would prefer to have it in their account.

They would prefer to have it for safekeeping, fraud protection. They'd prefer to have it in an account for interest bearing savings. And so there's still a incentive for one to link their dollar card to an account. And through that account requirement, you're capturing the KOSE requirements and the AML requirements there.

And then, I mean, it's a thought exercise that I'm interested in exploring with you guys, but one could also sort of limit the values that can accrue on the card to some threshold amount, or some maximum amount before we think this is a significant AML risk, or if you get to a certain limit on the card then you have to make more robust disclosure. You'd have to link it somewhere. And so there are ways to curb some AML risk that I hear, but in essence, I think it's even more limited since they cash, and so to create a cash equivalent which is an electronic version. There is going to be some inherent risk which I think it's there with paper money.

MR. SELGIN: I'm glad Nakita is taking on the unbanked question because that's so much harder than allowing people who have access to banks or use mobile payment programs and other apps that themselves rely on banks to make payments. Speeding up the payments that do work through the banking system is relatively easy. It's getting payments to people without banks that's much, much harder. So anybody who has ideas about that, I'm all ears, and I wish I had some.

I'd just like to say a couple things. On the question, Aaron, of the risk in settlement, you may well be right. It may be small, but it's providing the main, let's say, argument on the other side, and it's probably an argument with which the Fed itself is sympathetic. They're all about avoiding risk. So the easiest way to get around that barrier to progress, assuming it's a barrier to passing the law that you would like to see passed, or as a way to make it possible to get that thing done is just to say let's have the Fed fix up its settlement facilities. And then there will be no such excuse for not insisting on these funds being released quickly.

So I see these things as complementary rather than as we could either do this, or we could do the other thing. Let's try to do both. But both is best because no one then has anything to complain about really.

The other thing I wanted to say is in connection with what Peter said about the statutory authority of the Fed in particular. As a supervisory agency, it does have regulatory authority over so called systemically important payment facilities. There's another name for it. It's got an M in there. Someone help me. But you know what I mean. And one of them in the clearing house.

One of the reasons the Fed says Fed Now is so necessary is because, oh, the clearing house might do a bait and switch with RTP and charge high prices if they don't have us competing with them. I think they should just regulate it as what they call it, a utility. If it tries to raise its fee schedule, they should have the statutory authority to put some pressure on them to prevent them from doing it.

It's a lot cheaper to keep their fee structure the way they would like it that way, than build a whole new set of rails as a way to regulate the fees that it's charging. That's just a though, mind you, but it's one of the things they could do.

MR. KLEIN: Let me jump on that. Are you saying that if the Fed applied the same logic to payments as banks, they would insist on developing a repo bank because they're several private banks that so systemically important repo? But the Fed says they can regulate one market, but on the other they have to operate, is that what you're saying?

MR. SELGIN: That's right. Yes. That is. I don't think that they have to. I think they could regulate in this case to achieve the goals. And right now it's only the threat of regulation that's necessary because so far RTP has a fee schedule that is fine. The biggest threat to the RTP fee schedule which doesn't include any volume discounts at present, so it's friendly to the small banks comes from the Fed's rival system. Because, mark my words, the odds are that if it makes any real attempt to recover costs as the Monetary Control Act says it eventually much do, where eventually come be infinite time, as far as the Fed's interpretation of it is concerned.

But anyway, if they do make any serious attempt to do that, they've going to volume discount. They're going to do it to try to compete with RTP. So it would be better not to have them compete, and have the Fed just insist that RTP keep its present fee structure, and the small banks are going to end up better off.

MR. CONTI-BROWN: I'm not sure what our listener's appetites are for heavy-duty statutory analysis. I'm interested in it but let me keep it at a relatively high level here. I think that the kind of thought experiments that Nakita's proposing and that many others have done, some of these are just trial balloons, some of them are quite robustly developed and have made their way into legislative proposals are vital. So they're absolutely a vital part of the conversation and so no one criticizing them about their workability, about their exacerbation of preexisting inequalities should be seen, you know, or should attempt to shut down those conversations.

I think the thing I worry about in addition to KYCAML concerns about something like these ideas. And I would say, Nakita, do you have a name for your proposal? Dollar cards or?

MS. CUTTINO: The dollar card, yes. Currently dollar card.

MR. CONTI-BROWN: So I think the dollar card and in said accounts or postal banking and some of these other alternatives, I worry a little bit about this problem of whack-a-mole that it seems to be introducing. So our existing structures, as Aaron is absolutely correct in saying, are very broken. And so let's start over with this other thing that I worry would either recreate the existing inequalities and exclusions, or in some cases make them worse. And so that, I think, is the challenge that folks who propose to tackle this vital question have to overcome.

Why will you not just recreate the political economy that has produced this fracturing? Why will you not create the exclusions through cultural adaptations of the preexisting structure? And if you can't be sure that you're going to do so, there's a reasonable chance that you could then introduce some unintended consequences that could make these problems worse.

Now to Aaron's point about the EFAA passed in 1987, I just think you're wrong on the law here. I think the law is directed at the banks, not the Fed. So the banks have a pretty clear answer. It's not immediately. The statutory language is not immediate provision of these funds, it's as soon as possible. And that --

MR. KLEIN: Which is immediate. You can make the funds immediate if you want to. The technology's there. Real-time payments has been around for decades.

MR. CONTI-BROWN: I don't think it's as soon as technology allows it. I don't think that's the --

MR. KLEIN: As soon as possible.

MR. SELGIN: It gets pretty fuzzy because strictly speaking, it's technically possible for a bank to give you funds before a payment order has been made.

MR. KLEIN: In fact, George is so correct, a few banks leaned in to do the right things by customers, and gave them access to $1,200 on Good Friday before --

MR. SELGIN: Before the Treasury sent.

MR. KLEIN: I'll go one step further. If I had been king of Treasury but not the Fed, on the $1,200, I would have moved the money through RTP. There's nothing that requires the Fed to move the money through ACH. The Treasury. I'm sorry. I misspoke in a technical panel. The Treasury Department chooses to use the Fed's ACH network. They don't have to. RTP is better and faster.

In fact, as Nakita points out, the Treasury and ACH are so limited that they have to resort to sending these pre-paid cards when 93.5 percent of Americans have bank accounts. But 23 million Americans filed their taxes using basically a fake bank account in order to get an expedited tax refund. Right.

MR. SELGIN: Yes. That's where a lot of the holdups were.

MR. KLEIN: And so the Treasury thought they had a bank account put to a customer, but it wasn't. These people aren't unbanked, right. But it takes so long to get your money back, and the tax preparer had this system. Meanwhile, you know, I agree with you, Peter. The Fed regulatorily could fix this.

You know that there are multiple banks that make more than 100 percent of their profit on overdraft. In fact, of the seven banks that have more than 50 percent of their profit on overdraft, several are part of an umbrella bank holding company, brother and sister banks. So the Fed has bank holding company regulation over a series of chains of banks that aren't really banks. They're check cashers with a charter. They only exist on overdraft fees. But they're considered operating safe and sound. Why is the Fed not using its regulatory authority on bank holding companies that are essentially running check cashing business?

MR. CONTI-BROWN: We're completely in agreement. I think it's the path to get there. There's a statutory provision, though, in the FAA that would thwart you as well. And it's just with what kinds of funds are applied to that provision. And so --

MR. KLEIN: $25,000.

MR. CONTI-BROWN: No, it's that it excludes wire transfers and applies to cash, coin, and checks.

MR. KLEIN: Checks.

MR. CONTI-BROWN: So I think you've got some obstacles there, but we're totally in agreement, and this is why this feels like relatively legalistic and narrow. Totally in agreement that there are substantial alternatives. The sift moves that George is talking about, systemically important financial market utilities would apply to the clearing house.

The Fed has already exerted supervisory authority over the clearing house RTP by virtue of the joint account that it has with the Fed. Over which the Fed has nearly plenary supervisory and regulatory authority. The Fed has supervisory authority over technology service providers which it could exercise there. Something I alluded to earlier, the Fed as a market participant can do this as well, not just as an operator.

I'd like the idea of an operator, in the way that George does not. So I'm cautiously optimistic about Fed Now. I have no idea what the world will look like four years ago in my own household, let alone in pandemic America, let alone for real-time payments. And so I think the motivations of the Fed to do as it has done, to not be more aggressive as a regulatory of RTP when, in fact, the Fed invited the RTP proposal and sent very encouraging signs. I think the clearing house and the banks that own it have a legitimate grievance with the Fed given that bait and switch. But I'm also pretty sympathetic to the idea that all other financial institutions don't need to go crawling to the eight largest banks in the nation in order to participate in this kind of payment network.

So we've got so many options to resolve this pernicious problem. And I think it's worth asking the question, well, then why on earth has the Fed not done more other than commission a series of studies over 25 years, do a very heavy market signal that it wanted the clearing house to develop this infrastructure, and then reverse itself and say you should do that, but we're also going to be a competitor, but just not for four years. Meanwhile, disclaiming that supervisory authority over both the clearing house and the technology service providers that play such a vital role. So I don't want to be seen defending the Fed here because I think it's made a lot of mistakes.

MR. KLEIN: So let's pivot briefly from the conversation we're having about the regulatory mistakes, the policy mistakes, the impact on law and banking, and talk about the impact on people. Right. Because we all only really care about this because, you know, behind every payment are two entities. One sending money, one receiving money. Right.

And, you know, particularly as income has gotten more volatile, as wages have failed to keep up with cost. As Peter alluded to, as family structures have struggled and, you know, as the economy has cratered. We're having real consequences, and whether the answer is in March we can hire a third shift. Somehow, I don't know if the economy can add 10 million jobs a month, but the Fed can't hire a third shift until March. Or we can build a payment now system when Peter's household has settled down in four to 17 years.

Nakita, what does this all mean? What are the consequences to real people of, you know, years of conversations like this not moving the ball forward in a concrete way?

MS. CUTTINO: Yes. That's the real problem because the luxury of time many people don't have when it comes to solving this problem. And so what does it look like? It looks like just a steady drain on all ready limited resources for the most financially vulnerable Americans. Both are responsible estimated, by some estimates, $10 billion in non-sufficient fund fees, late charges, utility reconnection charges. They also drive some of the demand for high-cost fringe financial products like check cashing services, like overdraft protection, or even payday loans. That promise instant of quasi real-time access to funds.

Indeed, there have been things, as you know, Aaron, and you've reported before that banks have documented millions of bank customers that incurred overdraft charges for just a single day delay in their sort of direct deposits clearing. And so it's really a couple of days that are costing people significant portions of their limited resources. And then you have new innovations that affect financial technologies that come about to create more solutions for this real-time payment problem, but they come with more costs to consumers as well.

And so I think that is what's really at stake is as we're trying to come up with solutions, how do we address them quickly for those who are quite vulnerable? Especially, as we've already discussed here, in light of the pandemic, you have consumers that are Americans who waited three weeks to several months for their stimulus benefits. Unclear how they bided their time between there, but one could imagine they incurred overdraft charges or took on costly loans. And so that's what's really at stake. Just a snowballing of fees and costs that aren't necessary, when we could really solve this small portion of their problem.

MR. CONTI-BROWN: I think that the tax on poverty, for poverty's sake, or the tax on uneven income flows for their own sake is extremely pernicious. And that's the problem. Where we sometimes conflate the debates are where the costs of participation in the payment system is expensive because of things like default risk. And the question of where that default risk should be born is a tricky one.

Folks who would favor more market-oriented solutions would say, look, interest rates are high, overdraft fees are expensive and the like because these things cost something. And so maybe the profit margins here are actually quite slim. I'm going to confess agnosticism on those points, but I think where we should be targeting our subsidies, quite separate from simply turning the Fed's lights on and doing all the things we were talking about in the first half of our discussion. Where we should target subsidies and interventions in reducing the costs as costs per poverty, I think is the question.

I favor direct transfers more. That are not so dependent on the ways that paternalistically we may want individuals in households to spend their money. So I feel a little bit more uncomfortable by subsidizing specific financial services when, in fact, somebody might feel very comfortable being underbanked or unbanked but absolutely needs an awful lot of help with childcare. And so these are part of the same conversation.

So direct subsidies strikes me as more apt a tool for this problem. But I think where we should be directing it, and where I hear Nakita eloquently diagnosing this problem, this perennial problem isn't exactly the same place. Where people are identically situated, their default risks are the same, highly regressive policies that we're talking about might function culturally on the back of higher default risk. But to the extent that they're independent of that default risk, then this is something that is a problem for public policy.

MR. SELGIN: I'd like to take it back to payments. Even though I will say, as Peter did, and as everybody recognizes, that the problem of inequality is a huge problem and payments are a very small part of that. But I agree with Aaron that any little bit helps, and if we're chipping away at very small amounts of income every time people make a transaction or draw a check that turns out to exceed their account that's extremely costly.

But what I wanted to say in that connection is, and this ties, again, into my differences with Peter on Fed Now. Fed Now is, I think, itself kind of a regressive policy choice for the Fed to be taking in the sense that, look, we've got right now a horse and buggy payment system for most payments. What the Fed is now proposing to build, probably at the cost in the neighborhood of a billion dollars because it cost TCH about that much, and all those costs have to be replicated on the Fed's rails to build a supersonic jet.

The poorest people will probably make the least use of that supersonic jet when it's finished because for most of their payments ACH and checks are still going to be widely used. We can't assume anymore that Fed Now is going to become the total replacement for the existing payments made by check, debit card, etcetera. Not to mention all of the satellite systems like Venmo and so on.

In fact, those are growing gangbusters right now. So the best thing that the Fed could do to improve the speed of payments for poorer people is not to invest in the SSD, but to get to the intermediate solution of the Tesla or whatever we want to call it that everybody can afford. Because instant payments are also more expensive, and everything has economies of scale.

So you have this very cheap solution that I keep harping on because it's so important, and it's one that unlike Aaron, I don't think the Fed has done a great thing at all lately. And it's not just because it's talking about Fed Now, it's because it's not talking about the other thing. It's because it doesn't want anyone to think about this other solution. It systematically ignores it.

Can I show a slide? One slide, if it works?

MR. KLEIN: Let's roll the dice.

MR. SELGIN: Can you see a slide now? Are you seeing it?

MR. KLEIN: Yes, I think so.

MR. SELGIN: Okay. This is the Board of Governors in 2012 February 24. The Fed intends to explore expanded hours for the Fed wire fund service and national settlement service up to 24/7 365 to support a wide range of payment activities.

MR. KLEIN: That's awesome. When did it happen?

MR. SELGIN: 2012.

MR. KLEIN: No, they said it in 2012. They must have done it, what, nine months? Eight months later?

MR. SELGIN: Yes, you would think so. Let's see. Oh, for some reason my slide isn't progressing the way it should. Hold on just a second. Let me go back to my screen. I'll stop share. Now I'm going to go back to my slide show if we can.

MR. KLEIN: Great. Let's see. Let's see when this happened. It sounds like a great plan.

MR. SELGIN: Now I've got to go back to sharing the screen again. Hold on. Can you see my screen?

MR. KLEIN: Not yet.

MR. CONTI-BROWN: 2012 was when my second daughter was born. My first one was 2010. She should be starting high school by the time we're expecting (inaudible).

MR. SELGIN: I'm just going to share the screen this way. Hold on.

MR. KLEIN: Here's the thing.

MR. SELGIN: Can you see it now?

MR. KLEIN: Yes.

MR. SELGIN: Okay. The fancy stuff is gone. But below is the Board of Governors in August. The Federal Reserve continues to explore expanded hours for the Fed wire. It's exactly the same text. They've been asked to do it all these years. Now they're afraid that if they do it, what will happen is they'll take all of the air out of the Fed Now balloon because it will accomplish most of what they say Fed Now is needed to accomplish.

I think there's a real serious bureaucratic failure here and I think more people need to be aware of it. Because the poor would benefit more from this easy solution, then they'd likely to from the Fed Now. And they'll end up paying their share for Fed Now, all those millions or hundreds of millions. It'll come out of general banking fees and so on born by everyone, so that businesses, mainly, and some well-to-do people can have instant payments because it's more important for them to have those.

MR. KLEIN: George, let me just jump in on that point because I do think that we live in a very, very different world as to who bears what cost. And we have a process by which the cost of the slow payment system are radically born by, it's not even the poor. The FDA sees data indicates that four times as many people use a check casher, payday lender, or wire transmitter who have a bank account, and there are people who don't.

It strongly hints that the majority of people who go to check cashers have bank accounts. Why would you go to a check casher if you have a bank account? $20 to get your cash on Friday, $35 per overdraft to wait for it to settle into your account Tuesday or Wednesday. Your points about weekends and holidays are spot-on.

And so it's really a middle class -- the $35 billion a year in overdraft, $24 billion a year in payday loans are exclusively born by people with bank accounts.

MR. SELGIN: That's right. Of course.

MR. KLEIN: And while, Peter, I grant you real-time payments would not solve a lot of that. It wouldn't solve the majority of it. But if it solves 10 to 20 percent of it, but here's what it causes, huge losses to a select small number of banks that are overdraft giants that are regulated that the bank regulators don't want to see take giant income hits. Some of them might even be forced to close.

And so we have this giant problem. I want to hit a question because we can talk about this all day. It's coming from the audience which has to do with what type of reg E protections. That's electronic disclosures. Are needed with respect to real-time payments? We have lots of different fee disclosure. Every time, you know, you use your ATM you get these withdraw fees. I worked on the Card Act. There are huge problems with pre-paid cards and fee disclosures.

Nikita, you have some ideas. I assume you've thought through the disclosures' issues with your fed card that would come. Peter, you've been very critical of the problems in supervision and regulation. But when you move to a real-time system electronically, we still live in these paper-based, you know, what is it? One of the good quotes.

"We have a disclosure policy based on 8 1/2 by 11 in a world that lives in 3 1/2 by 5." So how would we modernize reg E or would we need to? How would that interact?

MR. CONTI-BROWN: We would absolutely need to, I think, if I can jump in on this. So reg E is about all electronic disclosures of all kinds of financial services. So this is -- its primary purpose is consumer financial protection. Why this is still at the Fed as opposed to the CFPB is because this was, along with the CRA and a couple of other statutory authorities that are consumer oriented stayed at the Fed. And a lot of this has to do with different kinds of lending relationships. So truth in lending and disclosures, consolidating fees into a single annual percentage fee, and the like.

And so I don't see real-time payments having much to say with that. The biggest issue is going to be -- and I do think enthusiasts for real-time payments, myself very much included, my very sophisticated co-author David Wishnick on this article, I think, is more thoughtful than I am on this. But the question of what to do for unauthorized transfers that settle instantaneously. That is a very hard nut to crack.

It's related, of course, to AML, but it’s not only that. The second your fat thumbs hit send and it settles instantaneously. Then you're like, wait. What the hell did I just do? And you call them back. On Venmo, good luck, right, getting that back. Sometimes you can succeed but that's within

Venmo which is a closed space. It essentially operates as a separate payment rail. But here it would be gone, gone, gone. Think about Nigerian princes in Western Union.

MR. KLEIN: But I mean hold on a second, right. Like somebody steals my debit card. They go fill up a tank of gas at Exxon, right. They zoom off, right. Not my car, I've been electric, but hypothetically someone else. Right. That gas is gone. That money may get put back in my account, but the fraud is gone. Right. My wife had her wallet stolen. Someone charged up a bunch of stuff at CVS. Right. The real-time payment fraud rates in other countries.

I mean, Nikita, how would you handle that? How would you handle the reg E and consumer disclosure?

MS. CUTTINO: That, in my proposal, actually is -- because the dollar card is treated like cash. Like Peter was saying, to the extent there's a lose of a card, to the extent there is a mistransfer of funds. The disclosure would be that that's lost cash. It doesn't get the same sort of protections as you would, say by fraud protections on your credit cards or debit card, or bank account because it's not account based. And so that is actually an incentive to linking it to an account and preserving the importance of having a deposit account.

So the disclosures for the dollar card would be this is the functional equivalent of cash. You lose it, you lose it, actually. It looks like you were going to say something, Aaron.

MR. KLEIN: Would you say it's a digital dollar?

MS. CUTTINO: It is.

MR. KLEIN: Because lord knows, that'll get you in the media.

MS. CUTTINO: But it is. It's a digital dollar that doubles as a physical form of that dollar. And that's sort of what's the benefit of it for? Those who lack smart phones or constant access to internet. It is a digital dollar that has a physical form that can be transferred as well. And so as such, if you lose the card, if it's stolen out of your wallet, it's the same as if cash was stolen.

MR. KLEIN: It's a bear instrument.

MS. CUTTINO: Exactly.

MR. KLEIN: If I could add to this discussion, I think there are three kinds of things we're talking about when it comes to risk, fraud, and mistakes. So we've got bear instruments, cards, where you lose it, it could go anywhere and you can't prove that there was a transaction intended, unintended, fraudulent or otherwise. There's nothing.

When we turn to electronic instant payments, the problem is that there's no changing your mind between the time you push the button, as Peter suggested, and the time things settle. So you can't call your bank and say I've changed my mind, I don't want to send that money. Now, banks do, some of these instant payment providers do protect you if there's a hack or some fraud using your account information. They still will cover that, even for instant payments.

What they won't do, is if you say, oh, I didn't mean to buy that, you know, new Mustang and I want to cancel the transaction. The payment providers are going to say, well, you have to call the Mustang dealer and figure out how to handle that with him. That's not a payments problem. So that's the distinction that's out there.

And then the reason why I think it's important is because two things are true that aren't true of the cash or cash card example. One is you do have a record of the transaction. So you can at least prove that you sent it and it was your money, etcetera. And second, you may have recourse because some of the people you buy from or send a payment to might, indeed, be willing to say okay, we'll reverse this transaction. So it's not quite as bad as losing cash.

MR. CONTI-BROWN: Sure. I think that this highlights, actually, something pretty interesting about the nature of these types of charge reversals, and why credit card companies are so eager to do it for their wealthy customers. And that I think that banks and other institutions that are providing real-time payments would be much less likely.

And that is the way they monetize the float. Right. So if you are participating in any kind of non-real-time payment system, and Venmo is thriving on undisclosed profits in this exact model, is that the process of placing this money that is within that ecosystem is very profitable and very destabilizing.

Now, eliminating that while highly pro-social is part of what makes this problem so sticky, even though virtually no one would defend our current payment system. So that might make you think along public choice type lines. Why people who are monetizing the float -- I'm not even talking about overdraft fees, but just taking advantage of money during the time in which it's being cleared would be reluctant to endorse a fast transition here.

But it also raises questions about sometimes what they do when they monetize that float is provide buffers that can be pro-consumer and beneficial to their customers. And if we eliminate that what follows? Now, out of fear of the future we simply can't remain in status, so I think reg E, back to the question, would require a modernization that might be sensitive to these types of issues. That would have to sort along the lines that George and Nakita describe between a more worthy and less worthy instances of reversibility.

But remember, that reversibility is more a metaphor. It's about who's carrying ultimate costs because these things are not going to be reversible, absent significant expenditure of locating where fraudulent transfers had occurred. But I think that's part of what the conversation would have to be as we transition into that kind of a system.

MR. KLEIN: That touched upon one of the questions that just came in from the audience. I'm a big fan of the Coase theorem in economics which, you know, cites that under certain assumptions, if you assign property rights and create a market, then the market can sort it out. That's exactly what happened in air resolution with debit cards, with the Electronic Funds Transfer Act, EFTA, not EFAA, where they assigned in the 1970s what was a very high threshold for fraud for $500 would be born by the customer, escalating up, depending on how long it took them to report to the bank. You know, 60 days you could lose your card and not report anything, and then be protected up to $1,000.

And in fact, I think about this. If we'd been around in the 70s, there would have been knockdown, drag out fights between the consumer advocates and the banks, $500 would wipe out the savings of millions of American families in the 70s. But banks are exposed to infinite risk on the backend if these debit cards are stolen.

And they fought and fought and fought and fought, and finally agreed on this number.

And in the end, it doesn't matter. Right. In the end the Coase theorem worked, there was enough of incentive for banks to create a debt fraud network that was robust enough for customers to, you know, then get secured, and people competed for each other's business. To the point where wealthy customers now have, basically, zero liability, and that it's actually gone down in risk. Right.

Now the biggest risk any of us have in signing our card to a credit card is not that our signature will do anything, but that we'll get COVID from touching the sticky pen. And somehow, yet we can blow up the entire world, but we still all have to sign for things. I still don't understand that. We're almost at the end of time, and I still have two questions that I haven't gotten to, and I'm going to pose them both to give a potpourri so everyone can pick their favorite one.

The first starts with this Coase theorem. Because, Peter, as you well know the Coase theorem is, what, the most cited economic theorem in legal practice. And here we are, you know, have a couple of economists and a couple of lawyers. A lot of the scholarship on this stuff is on money and cards. You mentioned the Fed accounts idea from Morgan Ricks, Vanderbilt Law (drops audio). Marissa has her postal account idea, law professor. Nakita's idea on these digital cards, law professor.

So I wanted to ask, one, why is so much of this smart thinking occurring in the legal world, not in the economic world? And two, at the same time, I want to go back to something George said about who's going to solve all this. You know, Square came out with a giant announcement this week between when we noticed this event and when we did it about instant payments and payment processors.

And they talked about this cupcake shop in West Virginia which I've been thinking a lot about, about this woman, right, as you talked about the flow on the banking side and the business side. But this woman who runs cupcakes has to pay her employees on Monday so that they get their paycheck on Friday. If she's a day or two late, it falls over to the weekend. During Thanksgiving people get their paycheck routinely on different dates. She has to have the money to meet payroll on Monday.

So there's all sorts of float, small businesses in particular. Square jumping in here as a payroll processor, this could be a game changer. Why do I pay my employees through my payment system in my bank, when Square can take their money and digitally put it in their Amazon account and move it that way? You know, or their bank account? You can pick. So is tech going to -- while we wait for Fed whatever, is tech going to solve this problem in a very different concept than any of us are thinking? So two questions, jump ball. Everybody pick their favorite and two to respond to. Go.

MR. SELGIN: Well, I'd like to respond to the first by saying I don't think lawyers are that much smarter than we are. They just have --

MR. KLEIN: A standard deviation or two.

MR. SELGIN: Only some. Only some. I'll say something about the second since I've opened my big mouth already. I think if even if nothing else happens, if the Fed does nothing else, by 2023 or 2024 when Fed Now gets going, and remember, when it opens that doesn't mean that everybody signed up. They have to hook up to it and that takes time. It could take several years before, so we could be talking 2025, 2025 before you have a well-subscribed Fed Now network.

By that time I believe so much will have happened in the space of these older payment systems, but not in the check system, but in all these satellites that have built around ACH and other payments. That they will be very fast, and there will be so many networks that you can do fast payments, instant payments, but they won't be complete. They'll just be a lot of different little networks and the amounts involved will be different, but we'll see tremendous growth.

If the Fed would open Fed Wire and NSF 24/7 365, it would enhance Square because Square has to settle, too, through the banks and all those others. It would merely accelerate the extent of the growth in these alternatives. And I think it's going to be huge. And that's why I worry, Peter, that Fed Now is going to look like a choo choo by the time it's actually set up, not like an SST.

MS. CUTTINO: Just to sort of echo some of that on the second point, I do think the technology in the marketplace just makes the market innovation or makes the market important because the innovation should come out of there. But I do still think the Fed or government coordination is necessary to streamline all of the different payment systems and innovation that's going to happen to make them interactable, to ensure that everyone has access.

I still think there's going to be some central coordinator or facilitator that makes the system work smoothly. And so will the tech and markets solve it faster? Yes, they're likely to come up with the answer. But how do they make it ubiquitous? I think governments will have a role for that aspect.

MR. CONTI-BROWN: Let me tackle the first question because I'm also a historian, and I think the intellectual history of the disciplines that we're talking about are really important here. I will not beg the question. I think you're right that legal scholars are paying more institutional attention to these kinds of issues. In part, because that's the comparative expertise.

I'd also note that the economists who are doing so with sophistication, I would be tempted to bestow honorary law degrees, and George would be the first one to get it. Aaron too, frankly. And that's because to answer this --

MR. SELGIN: You've increased my hourly rate now.

MR. CONTI-BROWN: I expect a cut. It's because in order to address these questions, you have to have a sense of the institutions that you're engaging. It is very common for economists of all ideological stripes, the elite, non-elite, academic, non-academic to make very careless errors about how these institutions actually work, whether we're talking about the Fed or we're talking about the payment system. And for better or worse, probably both, these are institutionally complex phenomenon.

Now, that said, we can exaggerate how much legal scholars are paying attention to this. It's a lot more fulfilling for a lot of legal scholars and lawyers to track second by second Supreme Court drama, then it is to have big debates about the EFAA. That said, I think that this is a space where interdisciplinary work, recognizing the comparative advantages that economists, historians, sociologist, anthropologists, and of course, legal scholars, and practitioners in this space all have to contribute to each other.

So being a scholar of financial regulation right now, I think we're at the beginning of a golden era and payments and infrastructure is no exception. Work by Dan Ariely and Kate Judge and Lev and Morgan and Marissa Broderson, and we've been talking about my co-author David Wishnick.

Nakita has a piece that I'm surprised she didn't mention. It's just right exactly on question two about early wage access programs. It really is a golden era and a time for scholars of all stripes and practitioners to start tuning in because the quality of the work that's coming out is very, very high.

MR. KLEIN: Well, on that note, we all have some research papers that we've put up on the web page associated with this event. I encourage everybody to read that. I tend to think that if we're in a golden age of debate and dialogue, it's because we've been in the stone age of action. The last major modernization of some of these funds were years ago, decades ago. The rest of the world is light-years ahead of us.

In China, two tech companies, Alipay and WeChat, Chinese Amazon and Chinese Facebook have essentially taken over the retail payment system with a better, faster, cheaper, more equitable payment system. I share the concerns uttered here about the growing recessivity of our payment system, and the consequences that has for real Americans.

Whether you agree with any of us or all of us on what the right solution is, I leave it to you. But I think that this conversation is going to be going for quite a ways because, very honestly, you know, it is painful for people who are still waiting for their funds, and we're going to address and fix that as soon as we can.

Thank you very much for joining us all. Thank you to my fellow panelists and wish everybody the best afternoon and a happy and healthy New Year.

MR. SELGIN: Thanks, Aaron.

MR. CONTI-BROWN: Thanks, Aaron.

MS. CUTTINO: Thank you.

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