Increasing Payment Efficiency

Weil, Gotshal & Manges Roundtable

March 3, 2017
Overview

- Creating a New Core Real Time Payments Infrastructure
- The RTP Legal Framework
- Specific Legal Considerations Regarding the Use of Blockchain in Payments
The Clearing House: Hub for Interbank Exchanges

**1853**

**Founded by** New York banks to improve efficiency and remove risk from daily exchanges

**TODAY**

**Owns and operates** core U.S. payments systems that clear and settle approximately $2 trillion each day, representing half of all commercial ACH, wire and check image exchange volume

**RIGHT NOW**

**Working to modernize the U.S. payments infrastructure by building a new, ubiquitous, real-time payment system**

**RTP**
The advent of mobile technology and the growth of digital commerce are driving real-time payments innovation around the world.

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<th>Year</th>
<th>Country</th>
<th>Initiative</th>
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<td>2001</td>
<td>South Korea</td>
<td>HOFINET</td>
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<td>2002</td>
<td>Brazil</td>
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<td>2004</td>
<td>Mexico</td>
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<td>2006</td>
<td>South Africa</td>
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<td>2008</td>
<td>U.K.</td>
<td>Faster Payments</td>
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<td>Chile</td>
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<td>2010</td>
<td>India</td>
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<td>2014</td>
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<td>2017</td>
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In October 2014 The Clearing House announced a multi-year initiative to build a ubiquitous real-time payment system for the U.S.

“In the case of The Clearing House, we look forward to seeing more details. They have come out in favor of a faster payments system, and that’s great.”

Governor Jerome Powell
Board of Governors of the Federal Reserve System
January 29, 2015

“The effort to bring faster payment settlement to the United States gained momentum this week with an announcement by The Clearing House Payments Co. LLC...”

John Stewart
DigitalTransactions.net
October 23, 2014

“The Clearing House is to be commended for moving forward and keeping the pressure on the financial industry to accelerate the speed with which payments are made in the U.S.”

Rene Pelegero
Former PayPal, Inc. and Amazon.com Inc. Executive, in American Banker
October 23, 2014

“The movement to develop a faster U.S. payment system has a new, influential convert.”

Sarah Todd and Kevin Wack
American Banker
October 22, 2014
What does TCH mean by real-time?

24/7
- Ability to send and receive payments 24/7

Information
- Real-time access to payment status information for originators and receivers

Funds
- Funds clear and settle continuously
- Funds available to receivers within seconds of payment initiation
What is a real-time payment?

Credit (push)
- No debits
- Payer controls payment

Irrevocable
- Once payment is released into the system, it cannot be reversed
- There is a mechanism to request return of a payment

Low value
- Currently limited to $25,000

Direct
- Payment goes from sender’s FI to receiver’s FI (No correspondent activity)
How do real-time payments happen?

- Real-time payments are executed through a sequence of messages.

**End-to-end Payment Flow**

1. The sequence starts with a customer sending a payment instruction via a channel made available by their FI. This involves the FI checking funds availability, conducting any required screening, and securely sending the payment instruction message to the TCH RTP core infrastructure.
2. RTP validates the transaction and routes it to the receiving FI.
3. The receiving FI responds to the message indicating that the payment is accepted (or in some cases either rejected or held for further review for risk management purposes).
4. RTP provides an acknowledgment message to the sending and receiving FIs, which the FIs must in turn use to provide status information to their customers. TCH immediately effectuates settlement for accepted payments.
5. If the receiving FI accepted the payment, it will immediately post and make funds available to the receiving customer’s account.
Overview of RTP Legal Framework

The legal framework for RTP consists of:

- Existing laws and regulations
  - Electronic Fund Transfer Act (EFTA)/Regulation E for RTP transactions to or from a consumer account, and
  - Article 4-A of the New York Uniform Commercial Code for commercial RTP transactions
  - Other laws applicable to FIs (Bank Secrecy Act, Gramm Leach Bliley, etc)

- RTP-specific materials that The Clearing House has developed:
  - the RTP Participation Rules and Operating Rules,
  - RTP Agreements (including the Participant Agreement)
  - RTP Schedules and Rules-Related Documents.
Existing Laws: EFTA/Regulation E and UCC 4-A

EFTA/Regulation E

- The EFTA/Regulation E (Subpart A) govern the rights and responsibilities of a consumer accountholder and the account holding institution with respect to “electronic fund transfer” services, including RTP payments sent or received by consumers from or to a demand deposit account.
- With respect to such RTP transactions, consumers will be protected under the EFTA/Regulation E (Subpart A), which include requirements regarding disclosures, error resolution, and limitations on liability for unauthorized transactions.
- The EFTA (Dodd Frank 1073)/ Regulation E (Subpart B) requirements for remittance transfers will not apply to RTP as payments will not be sent outside the U.S.

NY UCC 4-A

- Article 4A establishes a default, end-to-end framework of rights and responsibilities for banks and bank customers engaged in “funds transfers,” including business-to-business payments conducted through the RTP system.
- With respect to such commercial RTP transactions, the rights and obligations of the Sender and Receiver as well as the Sending Participant and Receiving Participant, will be governed by Article 4-A of the NY UCC, including with respect to liability for unauthorized or erroneous RTP payments.
Legal Considerations Regarding Blockchain & Payments

- Blockchain for consumer payments: EFTA / Reg E
  - Virtual currencies typically do not meet requirements of EFTA / Reg E
    - CFPB has declined to clarify applicability
    - Legislative history of EFTA suggests Congress intended broad application and in certain circumstances requirements appear to be met:
      - Virtual currency wallet provider or exchange provide an “account”
      - Public and private keys function as an “access device”

- Particular issues relating to Remittances
  - The remittance transfer sections of Reg. E are broadly written and would appear applicable to certain virtual currency businesses
  - The detailed notice, error resolution and cancellation requirements would appear to be highly problematic for virtual currency business compliance

- Nothing in EFTA or Reg. E, however, would prohibit use of blockchain as a recordkeeping mechanism for electronic funds transfers
  - Participant rules and agreements would need to deal with “unauthorized” transfers and error resolution
    - Would the blockchain be immutable with the sending FI absorbing the loss?
    - Would the blockchain be subject to reversal and under what conditions and authority
Legal Considerations Regarding Blockchain & Payments

- Blockchain for Commercial Payments & the Uniform Commercial Code
  - Virtual currencies themselves do not fit under UCC4A
    - Payment Order defined as an instruction to pay “money” (UCC4A-103)
    - “Money” is defined as a “medium of exchange authorized or adopted by a domestic or foreign government” (UCC1-201(24))
    - Because not money, but rather “general intangibles” under Article 9, virtual currencies are the least negotiable of all U.C.C. categories of property

- Nothing in UCC-4A, however, would prohibit use of blockchain as a *recordkeeping mechanism* for exchanges in fiat currencies provided there is a “clearing house” or “association of banks”
  - “Funds-Transfer system” defined to include “…other communication system of a clearing house or other association of banks through which a payment order is addressed” (UCC4A-105)
  - “Clearing house” broadly defined to mean “any association of banks or other payors regularly clearing items” (UCC4-104)
  - Funds-Transfer system rule provision of UCC4A can be leveraged to create system rules that accommodate blockchain technology (UCC4A-501)
    - May be effective even if rules conflict with UCC4A
    - May indirectly affect a party to the funds transfer that did not consent to the rule
    - May govern rights and obligations of parties other than participating banks using the system
Rob Hunter, Executive Managing Director and Deputy General Counsel, The Clearing House

Mr. Hunter serves as the senior lawyer supporting The Clearing House’s ACH, wire transfer, and check-image payment networks that clear and settle approximately $2 trillion daily. Mr. Hunter is also actively involved in counseling payments executives on numerous industry-wide product development initiatives in a variety of payments-related areas, including the development of a new real-time payments system, data security, mobile payments, electronic bill payment, medical payments, and other initiatives. As principal staff advisor on payments law issues for The Clearing House Association, the nation’s oldest banking association, Mr. Hunter is frequently engaged in representing the interests of The Clearing House owner banks on a variety of payments law issues through meetings with senior U.S. regulators and members of Congress and their staffs and through the filing and publication of comment letters, amicus briefs and white papers.

Mr. Hunter holds a B.A. degree from Northwestern University and a J.D. degree from the Duke University School of Law.

He is a member of the American Bar Association Business Law Section’s Banking Law Committee, where for many years he served as Chair of the Subcommittee on Payments and Electronic Banking. Mr. Hunter also serves on the Editorial Board for Thomson-Reuters’ FinTech Law Journal, the Board of Advisors for the Wake Forest Journal of Business and Intellectual Property Law and is a frequent speaker and writer on payments, technology and business law issues.