
BITS BULLETIN

A CURRENT REPORT OF ACTIVITIES FROM THE BANKING INDUSTRY TECHNOLOGY SECRETARIAT

MARCH 1, 1999

The *BITS Bulletin* is designed to keep the membership of The Bankers Roundtable fully informed about the activities of The Banking Industry Technology Secretariat (BITS) and rapidly evolving developments in electronic commerce.

BITS MISSION

The BITS Mission is to foster the growth and development of electronic banking and commerce in an open environment that will encourage greater choices in financial software, access devices, networks and processing capabilities for the benefit of financial institutions and their customers.

BITS INITIATIVES

- Accelerate the establishment of new electronic payment and product delivery systems by facilitating the development of interoperable specifications and standards.
- Create an environment for a safe and secure electronic infrastructure that will enhance financial service company brands and safeguard consumer privacy.
- Enhance consumer confidence and improve electronic access to financial services for the largest number of people.
- Enhance and support financial services brands.
- Leverage industry infrastructure to improve efficiencies and serve customers.
- Participate in the regulatory process for electronic commerce and payments.

**BANKING
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THE BANKERS ROUNDTABLE

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: **LETTER FROM THE CEO**

As we prepare for next month's Roundtable Annual Meeting, sweeping changes are occurring in the financial services industry. BITS is designing three major presentations for the meeting to address these changes—one on the Electronic Commerce Framework, another on Shared Utilities, and the third on a Fact-Based Analysis of the Privacy Issue. These presentations will provide valuable perspectives for strategic decisions that will affect individual banks and the industry as we approach an increasingly online financial services world.

The E-Commerce Framework Special Briefing at the Board and at the Meeting will feature a panel of distinguished industry experts and Advisory Group members, moderated by Allan Woods, Mellon Bank, Co-Chair, BITS *de novo* Steering Committee. Others on the panel are Bill Burnham, Credit Suisse First Boston; Tom Cirillo, Citigroup; Webb Edwards, Wells Fargo & Company; Allen Gula, Jr., KeyCorp; Janey Place, Digital Thinking; and Joe Sponholz, Chase Manhattan Bank. The panel will identify critical business areas, key players, and significant technologies related to e-commerce. The session will provide useful background for Scott McNealy's speech at the General Business Session.

The Shared Utilities presentation at the BITS Board Meeting will inform the BITS and Roundtable Directors about the role of shared utilities in the financial services industry, especially in an e-commerce context. This has been identified as a strategic issue by the BITS Advisory Group. Jack Stephenson of McKinsey & Company will make this presentation.

A panel on a Fact-Based Analysis of the Privacy Issue will include presentations by Gary Roboff, Chase Manhattan Bank, and Gail Magnuson, Bank of America. The panel will present results of the Research and Communications Steering Committee's work to dimension the implications of the data-sharing issue from a business perspective. One particularly significant deliverable is a "decisioning tool" in spreadsheet format that each bank may use to quantify process and systems costs, as well as potential lost opportunities, associated with changes in data-sharing practices—either by bank choice, legislation or regulation.

Also on next month's Roundtable Annual Meeting program is W. Brian Arthur, a distinguished economist and Citibank Professor at The Santa Fe Institute (SFI). SFI is a leading, interdisciplinary research institution that focuses on complex adaptive systems, including economic systems. Arthur is noted for his work to develop the concept of "increasing returns." His opinions have been cited in the Department of Justice's case against Microsoft.

All BITS initiatives are on track, with a complete update to be reported at the April BITS Board meeting. As part of these initiatives, a second Fraud Forum was held and four ECP Forums are being held over the next month. An Electronification Alternatives Meeting is scheduled for March 4th. A growing number of banks are formally committing to participation in both the BITS Fraud Reduction and ECP initiatives. The IFX Forum is now being established for governance and management of the IFX business specification, with a number of new Working Groups being proposed. BITS is turning this over to a standards body to manage.

BITS' Security initiatives include a proposed BITS Security Lab. Representatives of the Steering Committee on Security and Risk Assessment and BITS senior staff will combine interviews and field visits on March 5th as part of the final stage of the process to select an organization to manage the new facility. Two finalists are under consideration.

Catherine A. Allen

BANKING INDUSTRY TECHNOLOGY SECRETARIAT

THE BANKERS ROUNDTABLE

BITS Board of Directors

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Spencer Eccles, First Security
Charles Gifford, BankBoston
Robert Gillespie, KeyCorp
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Terrence Murray, Fleet Financial Group
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(ABA)
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Christopher Callero, Bank of America
Michael Caughlin, First Security
Marv Adams, Banc One Corporation
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Libby Ghekiere, Bank of America, *Standards*
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Sharon Osberg, Wells Fargo, *InteroperaBILL*
William M. Randle, Huntington Bancshares
Gary Roboff, Chase Manhattan, *Research*
Dan Schutzer, Citigroup, *FSTC Liaison*
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Joseph G. Sponholz, Chase Manhattan
Viveca Ware, IBAA
Allan Woods, Mellon Bank
Michael R. Zucchini, Fleet Financial

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COMMENTS FROM THE CHAIRMAN OF THE BOARD

BITS continues to be immersed in issues concerning the industry's readiness to meet the challenges of serving our customers in the emerging, electronic commerce environment. Some of the hottest topics in this context have to do with security, privacy, infrastructure leverage, shared utilities, and data sharing. BITS' work to address the topics is reported in this issue of the BITS Bulletin. We'll continue to see them arise in the legislative and regulatory arenas as well. It is critically important that we all know what is at stake, where we as an industry want to go, and how quickly.

On several major fronts, we already have a track record. Sixty-five percent of Roundtable banks have formally committed to supporting BITS' Check Fraud Reduction and ECP initiatives, with more expected. Now is the time for TBR to lead the industry into the new millennium by working on an industry-wide basis to make a fully functioning, interoperable, electronics payments system a reality. We've been talking about this for more than 30 years. We can, through BITS, make it happen—for our own sake and for our customers and shareholders.

Edward E. Crutchfield
Chairman and CEO,
First Union Corporation
Chairman, BITS Board of Directors

STEERING COMMITTEE AND WORKING GROUP UPDATES

Special Advisory Group Project: Shared Utilities Initiative

Chair: Michael Zucchini, Fleet Financial

A BITS project now underway will provide CEOs with a perspective on shared industry utilities, especially in an e-commerce context. Jack Stephenson and his staff at McKinsey & Company are interviewing key industry participants, profiling relevant examples, and developing a framework and guiding principles for the industry to be presented to the Board in April. Mike Zucchini and other Advisory Group members are guiding and providing input to the process. The report will describe how the major shared utilities serving the U.S. banking industry (e.g., check clearinghouses, card associations, ATM networks, technology consortia, etc.) differ by function, type, original intent and effectiveness.

"Results will include criteria to help CEOs make decisions about which utilities should be owned or shared, guidelines for establishing and managing utilities, and identification of business areas where shared utilities still make good sense," said Michael Zucchini, Fleet Financial Group, Chair of the Shared Utilities Initiative. Other key issues to be addressed by the project include the impact of changes in the environment (e.g., industry consolidation, technology shifts, new competitors) on the roles and functions of the existing utilities.

WORKING GROUP UPDATES

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Standards Steering Committee

Chair: Libby Ghekiere, Bank of America

IFX

Chair: Kit Needham, BITS

Now that the IFX business specification has been published for public comment and nears final approval, the momentum has shifted to establishing the IFX Forum for governance and as a structure for enhancing the specification. A number of Working Groups are being proposed: Small Business, Business-to-Business, XML Protocol Implementation, Investments/Securities, Multiple Languages, and Bill Presentment/Payment (continuation of work done to date).

A two-day meeting in Santa Fe of the IFX/InteroperaBILL Technical Working Groups in late February helped resolve many of the "loose ends" and bring the IFX Forum closer to formalization. Representatives of Data Interchange Standards Association (DISA), which will provide administrative support, participated in the meeting and presented plans for web site structure and content, membership solicitation, and general administration.

de novo Steering Committee

Co-Chairs: Allan Woods, Mellon Bank;

Frank Jaffe, Bank Boston

InteroperaBILL

Chair, Sharon Osberg, Wells Fargo

Electronic bill presentment and payment (EBPP) business practices were released on February 11th by the National Automated Clearing House Association (NACHA) and BITS. This follows the January 31st publication by BITS of the IFX Electronic Bill Delivery and Payment Business Message Specification which has been acclaimed by many as the precursor to the financial services industry's standard.

The EBPP business practices, available on the Bill Payment Council's web site (www.nacha.org/billpay), set forth recommended practices for billers, service and payment providers for both billers and customers, and for the customers themselves.

These efforts are the products of months of work by BITS' InteroperaBILL Steering Committee and its two Technical Working Groups representing a range of industry participants—all

under the auspices of the BITS *de novo* Steering Committee. In particular, Louis Fuertes, The Chase Manhattan Bank and Kelly Marlar, Bell South, who co-chaired the BPC Business Practices Task Force, supported by Cary Whaley, NACHA staff, deserve credit for their work.

Payments Framework Project

The Payments Framework Project is designed to build on the work of the original BITS Meta-Architecture Working Group. Joseph Sponholz of The Chase Manhattan Bank and Chair of the BITS Meta-Architecture Working Group, made a presentation to the BITS Advisory Group at its February meeting as background for this new initiative. (See BITS Profile in this issue.) He offered a brief description of the methodology, key observations, recommendations, and impact assessment of the original Working Group's systematic analysis of the industry's payments system. (The original BITS Meta-Architecture work is on the web site at www.bitsinfo.org/meta.) Next steps for this work will be addressed by the *de novo* Steering Committee.

ATM/Point of Sale (POS) Networks Analysis

The *de novo* Steering Committee is continuing its review of ATM/POS networks and issues such as consolidation, cost reduction, ownership by third parties and associated risk management. Possibilities of leveraging existing infrastructure to create new business and revenue opportunities are still one focus of the analysis. This work dovetails with the E-Commerce and Payments Frameworks projects.

E-Commerce Framework Project

Chair: Allen Gula, Jr., KeyCorp

Janey Place, Digital Thinking, who is coordinating this project for BITS, provided an update on the E-Commerce Framework Project at the February 11th meeting of the Advisory Group. The goal of this project is to provide a context concerning e-commerce, helping CEOs to evaluate business decisions, understand threats and opportunities in this area, take action regarding regulation and provide a perspective to help assist with individual bank strategy. The project's deliverables are a White Paper and presentation materials for both the Board and the BITS' Special Briefing at the April meeting.

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Meeting Dates

BITS Board Meeting
April 8-10, 1999
TBR Annual Meeting,
Naples, FL

BITS Advisory Group Meetings

March 11-12, 1999
Washington, DC

May 13, 1999
Chicago, IL

June 10, 1999
New York, NY

July 15, 1999
Santa Fe, NM

August 5, 1999
San Francisco, CA

October 14, 1999
Boston, MA

TBD
Phoenix, AZ

December 9, 1999
Washington, DC

BITS Industry Forums

May 12, 1999
Chicago, IL

July 14, 1999
Santa Fe, NM

October 13, 1999
Boston, MA

December 8, 1999
Washington, DC

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WORKING GROUP UPDATES

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Industry Infrastructure Steering Committee

*Co-Chairs: Austin Adams, First Union;
Webb Edwards, Wells Fargo;
Joseph Sponholz, The Chase Manhattan
Bank*

Electronification: ECP

Chair: Mike Pasiacki, The Chase Manhattan Bank
Four one-day ECP forums will be held in coming weeks to provide detailed background on Electronic Check Presentment, including ECP benefits, the legal environment, and an overview of implementation issues and considerations. Dates and locations are: March 10th, Philadelphia; March 23rd, Atlanta; March 24th, Kansas City; May 18th, Chicago. An additional two Forums will be held (May 5-6, Dallas, and June 7-8, Chicago) to provide bankers with an in-depth look at the ECP implementation process.

These national ECP Forums are an important part of the BITS' ECP initiative and are designed to enable more banks to participate in ECP. The first ECP Forum, held in December, had a strong turnout of senior people representing a wide cross-section of banks. The Forums include presentations from SVPCo, the Federal Reserve Bank of Atlanta, and ECCHO.

Electronification Alternatives Task Force

*Co-Chairs: John Beran, Comerica
Janet Smith, Wachovia*

At an organizing meeting on March 4th in Dallas, the Electronification Alternatives Task Force will be reviewing recent developments in the area of electronification and discussing what else is necessary to further the realization of a fully electronic and interoperable payments system. BITS has endorsed ECP as a first step in the electronification process; this group will make recommendations about next steps beyond ECP.

Fraud Reduction Program

Chair: Nancy Cloyd, Bank of America

A second successful BITS' Fraud Reduction Forum was held February 22nd in Las Vegas, with a special focus on serving banks in the West. In addition, the staff of some of the largest clearinghouses were invited to participate. At the Forum, the Fraud Working Group discussed its ongoing work including the development of a standardized data collection process for check

fraud statistics. This process, developed in cooperation with the ABA's Deposit Account Fraud Committee, includes the sharing of successful strategies on a regional and national basis. For more information please contact Jessica Hymowitz at BITS, 202-289-4322 x240. The forums are part of the Fraud Working Group's important educational effort to obtain bank commitment to the initiative.

Research and Communications Steering Committee

Chair: Gary Roboff, The Chase Manhattan Bank

The project to conduct a "Fact-Based Analysis of the Privacy Issue" is on track. The Project Working Group meets at least weekly, with two to three conference calls per week, and additional working sessions. The results of this intense six-month effort will include a "decisioning tool" for use by individual banks to dimension the data sharing issue in business terms at a macro level. The tool enables a "first-of-its-kind" analysis of banks' choices with respect to Processes and Systems involved in data sharing. From the beginning of this project, the BITS Research and Communications Steering Committee has sought to develop a tool that could be useful to individual banks from a strategic perspective. This goal will be accomplished. At its option, an individual financial institution may want to build on the tool to develop a more sophisticated model that might be used to test specific implementation scenarios. The tool will be accompanied by a White Paper that includes findings from this first phase of this project.

Further deliverables include two additional White Papers—one addressing P3P, a browser software that allows customers to choose various privacy options; the other addressing customer opportunities associated with data sharing.

All deliverables in progress will be presented to the BITS' Advisory Group on March 11th, in preparation for the April BITS' Board meeting and associated presentations at the Annual Meeting of The Bankers Roundtable.

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WORKING GROUP UPDATES

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Security and Risk Assessment

Steering Committee

*Co-Chairs: William Randle, Huntington Bank,
Peter Browne, First Union*

“Securing the Future of E-Commerce: Strategies and Initiatives for Building Trust” is the theme of the BITS-American Banker Security Symposium, to be held in Washington, DC on March 9th-10th. Mark Greene, EVP, Security Practices, IBM, will deliver the keynote address on “Business Issues Related to Security and Privacy.” Peter Freund, CEO, CERTCO, will discuss “Banks’ Role in Issuing Certificates,” which is related to the topic of a panel on Certificate Developments. Other panels will examine Critical Infrastructure Initiatives, BITS and Other Industry Security/Privacy Initiatives, and Electronic Consumer Protection. The Symposium is designed to educate the industry and government on how BITS and the financial services industry are addressing security and privacy issues, as well as to surface new issues to ensure the safe and sound delivery of information and payment products and services.

The BITS Security and Risk Assessment (SRA) Steering Committee continues to work with the Presidential Commission on Critical Infrastructure Protection (PCCIP) and will send representatives to a March 11th meeting at the White House, with the Secretary of the Treasury participating. The SRA is working closely with Treasury, developing industry positions on issues such as rules and structure of an oversight body, and criteria for reporting incidents or vulnerabilities to cyber attacks.

Two finalists for the management of the proposed BITS Security/Technology Lab are now being considered. They have been selected from a field of 11 respondents to the RFI. Selection criteria included capability (size, scope) and experience, trust and reputation, funding, cost sharing, location, expertise related to security and privacy, and ability to protect the confidentiality of the information obtained. The SRA was assisted in the selection and evaluation process by representatives of the Financial Services Technology Consortium (FSTC), Sandia National Laboratories, and Mitre Corporation. After additional interviews and field visits, a management recommendation is expected to be presented to the BITS Advisory Group at its March 11th meeting. The objectives of the facility—to be established in the Washington, DC area—are early product influence, risk reduction, implementation cost reduction, and security interoperability, among others.

A Sample of Electronic Commerce Statistics

Business-to-Business Sales Dominate E-commerce

- 75% of Web transactions happen outside of the consumer’s reach—that is, in business-to-business transactions.
- Businesses sold \$43 billion worth of goods to each other over the Web in ‘98—more than five times the retail total of \$8 billion last year.
- Business-to-business sales on the Web will reach \$1.3 trillion in four years, or 9.4 percent of all such sales.
- Worldwide e-commerce sales will reach as high as \$3.2 trillion in 2003, representing nearly 5% of all global sales.

Legal and Public Policy Working Group

*Co-Chairs: John Burke, Foley, Hoag & Eliot, LLP;
Rich Whiting, The Bankers Roundtable*

The Legal and Public Policy Working Group (LPPWG), in concert with the BITS Privacy Working Group, is evaluating Senate Bill 187, introduced by Senators Sarbanes (D-MD) and Dodd (D-CT). The purpose of the bill is to force financial services regulators to implement “rules to protect the privacy of customers of the institutions they regulate.”

With respect to legal barriers to electronic return of checks, the LPPWG is working with counsel for ECCHO to evaluate the regulatory amendments to Reg CC proposed by The Federal Reserve. These changes are designed to facilitate the electronic return of unpaid checks. Notice of the proposed changes was made by The Federal Reserve on February 22nd and comments must be submitted to the regulators before April 30th. Comments from counsel for BITS banks have been requested. Please send any comments to John Burke via e-mail at jburke@fhe.com.

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Joseph G. Sponholz is Vice Chairman, Electronic Commerce, The Chase Manhattan Bank. He serves on the BITS Advisory Group, is Co-Chair of the Industry Infrastructure Steering Committee, and was the Chair of the BITS Meta-Architecture Working Group. He is also Chair of the SVPCo Board of Directors.

This is a continuing series of interviews with members of the BITS Board of Directors, BITS Advisory Group and other key leaders in electronic commerce and financial services.

To provide background and context for BITS' ongoing E-Commerce and Payments Framework Projects, Joseph Sponholz, as Chair of the original BITS Meta-Architecture Working Group, was asked to make a presentation to the BITS Advisory Group at its February 11th meeting. Following are excerpts of his remarks.

BITS: What are a few of the most relevant findings from the original BITS Meta-Architecture study with respect to the emerging e-commerce framework?

JS: One of the study's first observations was that today's payments system infrastructure is highly evolved and highly sophisticated. Within a paper-based environment, it is perhaps the most efficient system available and handles the greatest diversity of transactions found anywhere in the world today. These highly evolved, efficient systems deliver a tremendous amount of value to bank customers—and all stakeholders derive value. Because of the evolution of these systems over time, the barriers to entry are clearing, settlement, and other core functions. The banking industry has achieved a scaled position in this area, and specialization, that would be difficult to replicate. The problem is that the end users, particularly consumers, do not perceive the tremendous value the system provides. Consumers probably view payment functionality as an entitlement, for example, allowing them to gain access to funds when and where they need it. We have made the payments systems function so smoothly, consumers don't even see it. Although we have significant barriers to entry in the core functions, we cannot build our market position solely on that core functionality. We do not believe there is evidence that new players intend to compete directly with banks at the core industry infrastructure level. Banks' losing the payments system at its core functionality is not going to happen, because others do not want to replicate our infrastructure, with a small return. Non-bank providers will attempt to leverage our core, and spend their time on value-added, perhaps where convergence of technology allows them to further leverage the banks' core infrastructure.

BITS: Describe the role of technology in the evolution of the payments system.

JS: The payments value chain is changing, largely because of technologies. The technology itself is driving a number of fundamental shifts for everyone engaged in commerce, not just for banks. New technologies are revolutionizing the business system as we know it—there is a dramatic decline, and a continuing decline, in costs related to PC technologies. Costs are dropping as functionality becomes greater and greater. At the same time, rapid growth is being developed in the whole Internet environment. Because of the technology advances in almost every domain—as we accept the view of the networked world—there should be more recognition of the revolutionary changes in the telecommunications environment. Declines in costs and ubiquitous, ever-increasing bandwidth, are enormous forces.

BITS: What are the risks to banks in this environment?

JS: For the banks, there is a real threat to be further distanced or disintermediated. Portals are another factor. Many of our systems were created as silos, discrete and separate. A networked world forces these things to come together with enhanced functionality in a virtual, channel environment. The new network-based services have most significantly developed on the Internet. In this BITS Meta-Architecture study, we spent a lot of time worrying about what would happen in a networked world. We early identified web-based purchasing, EDI solutions, and bill presentment/bill payment. It appears we saw this accurately. It is a mistake for us to become too fixated on one delivery channel. Issues for the banking industry around e-checks, debit cards, and tokens will remain with us—so we are cautioned not to lose sight of existing payment vehicles as we also look at the Internet. The biggest threat is that we wind up with only the core functionality—with the highest risk and greatest liability—and few of the benefits.

BITS: What are some of the implications for the banking industry?

JS: We have to transition existing payments systems from the physical to the virtual world. Much has validated BITS' Meta-Architecture work in this area. To protect our position in existing businesses, recognizing that checks will not go away, our challenge is to develop new interfaces and new ways to interface—to maintain control over the customer interfaces. Branding is likely to play a key role for individual competitors, and perhaps the industry as a whole. Non-bank competitors might be advantaged because they do not start with legacy systems. If you don't start with a legacy, you can leverage off the commodity components, and leave those to the banks. It is important to recognize and build upon the value of the current payments infrastructure. There should be a migration to transform our own processing systems. The dilemma is that, in the short run, our costs will rise. Once electronic, the individual products should be more easily leverageable into, ultimately, information-based businesses. The most effective way to ensure that the industry keeps its position is to participate in the standards process, encouraging multiple solutions to be provided by banks and non-banks.

BITS: What should be BITS' next initiatives in this area?

JS: I think BITS has already done mainly the right kinds of things. Through this Meta-Architecture Project, we believe we came up with the right observations. More work is needed, and leads into the work of BITS' *de novo* Steering Committee. I do think BITS' role as an influencer of other constituencies—for example, with the regulators—is an opportunity. There is an opportunity to reset the ground rules in the payments environment. To the extent we can educate on the technology side, that is helpful.