
BITS BULLETIN

A REPORT OF ACTIVITIES FROM BITS, THE TECHNOLOGY GROUP FOR THE FINANCIAL SERVICES ROUNDTABLE

FEBRUARY 2002

The *BITS Bulletin* is designed to keep the membership of The Financial Services Roundtable fully informed about the activities of BITS and rapidly evolving developments in emerging technologies, electronic commerce and payments.

BITS MANDATE

- Facilitate the growth of electronic commerce
- Facilitate development of superior, market-driven technologies
- Maintain the financial services industry's role at the heart of the payments system
- Sustain consumer confidence and trust by ensuring the safety, soundness, privacy and security of financial transactions
- Leverage resources and infrastructure across the industry

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LETTER FROM THE CEO

The new year got off to an exciting start here at BITS. The Roundtable's and BITS' Mid Winter Conference in January was an enormous success. Industry and government leaders—including President Bush, Secretary O'Neill, Chairman Greenspan, Senator Sam Nunn, American Airlines Chairman and CEO Donald Carty, FBI Director Robert Mueller and Homeland Security Director Tom Ridge—had an opportunity to discuss what our industry and the government can do, and have done, to protect critical payments and settlement and transaction systems.

In addition to BITS' focus on national security, we are also addressing critical issues emerging in the payments arena. Since 1997 we have witnessed an unprecedented surge in competition, regulations and technology as payments shift away from paper and into the electronic realm. A number of payments issues have emerged, and many more lie beyond the horizon. Some of the crucial issues we face are:

Competitive advantage. We need to better understand the offerings of competitors that might give them advantages over financial institutions.

Disintermediation. We must understand the risks of disintermediation and take steps to mitigate it.

Payment applications. There are fundamental changes taking place in the way payment applications relate to industry value propositions.

Transition management. We need to identify ways to better manage the transition from paper to electronic payment vehicles.

CRM. How our industry can best use customer information to be more responsive to customer need is a fundamental—and increasingly complex—issue.

As we work through these changes, the economic implications of each are paramount and the risks are many. However, the opportunities are equally significant. Fees can be gained from new functionality, such as aggregation, in which payment is only part of the value to customers. Product features such as check imaging and safekeeping also offer increased revenue opportunities.

BITS is privileged to be leading the way through this challenging period. We urge you to become involved at this critical time in our industry's history.

Catherine A. Miller

CEO, BITS



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Bill Sentenac, Wells Fargo & Co., *Security Lab*

COMMENTS FROM THE CHAIRMAN OF THE BOARD.

In January we held our Mid Winter Conference. Over and over since then, we've heard this was the Roundtable's and BITS' best yet. No wonder, with speakers like President Bush, Secretary O'Neill, Senator Sam Nunn, Homeland Security Director Tom Ridge and FBI Director Robert Mueller. All spoke about the heightened cooperation between government and business, and expressed great interest in working closely with the Roundtable and BITS to protect the U.S. critical infrastructure.

While crisis management came to the forefront this fall, payments and settlements have been a major focus of BITS' activities since day one. Beginning with the payments meta architecture project in 1997, BITS has worked to advance the financial services industry in a number of strategically important payments- and settlements-related areas. In fact, over the past four years, one-third to one-half of BITS' resources have been dedicated to these initiatives.

Why this continued focus? We see headlines every day about the extent of change in the payments and settlements system. Technology is enabling new functionality—almost, it seems, on a daily basis—and that technology is changing the fundamental nature of how transactions add value to our industry. New, effective competitors are everywhere.

Regulators are responding to the shift to electronic transactions by giving us the green light to greatly improve the way we do business with our customers. The E-SIGN Act of 2000 and the newly proposed Check Truncation Act are just two of many examples.

Our industry must keep pace. Today, BITS is leading us with initiatives that are advancing the industry in key areas, including electronic signatures and record documentation, fraud mitigation, electronic payments, check truncation, electronic check presentment and check safekeeping. BITS is also updating the *Electronification Alternatives Financial Model Overview and Technical Guide and Cost Model Spreadsheet*, which allows financial institutions to evaluate the economic impact of various electronification options. BITS' initiatives in B-to-B E-Commerce and Aggregation also add to BITS' value in this dynamic area.

Why does all of this matter? Because payments and settlements are critically important to our bottom line.

We need to understand the force of the changes underway in order to lead our industry into the future. With significant revenue at stake related to the payments sphere, we can't afford for BITS not to give us its best thinking on how to maximize the industry's competitive position.



James H. Blanchard
Chairman and CEO
Synovus Financial Corp.
Chairman, BITS Board of Directors

FOCUS: PAYMENT STRATEGIES

BITS' Initiatives in Payments

Advancing the financial services industry in the development of payment strategies, particularly the transition from paper to electronic payment systems, has always been an important part of BITS' work. Payment applications are a crucial part of revenue for financial services companies—16 of the top 25 bank holding companies generate 40 percent or more of their revenue from payments-driven products.

In Sept. 1998 the BITS Board of Directors set a goal that 100 percent of large financial institutions would process 50 percent of their checks through electronic check presentment (ECP). While many Roundtable member institutions have implemented ECP, the growth has been slower than expected, with 85 percent of large and 10 percent of medium-sized institutions implementing ECP. Current implementation efforts are largely driven by the Electronic Check Clearing House Organization (ECCHO) and the Small Value Payment Company (SVPCo).

In Jan. 2001, BITS formed the EA/ECP Steering Committee to help coordinate and support the efforts of SVPCo and ECCHO, to identify solutions for the removal of barriers to electronification (technology infrastructure, regulatory and marketplace acceptance), and to promote electronification throughout the financial services industry.

The Payment Strategies Steering Committee, Chaired by John Beran, Comerica, was established in Dec. 2001 as an umbrella group that provides oversight to all of BITS' payment-related initiatives. The following Working Groups fall under the Payment Strategies Steering Committee:

- **CTA Working Group** (Co-chaired by Tom Clifford, Wells Fargo, and David Walker, ECCHO) – This group identifies implications of and responses to the final version of the Check Truncation Act (CTA), which was presented to Congress on Dec. 20. This Group is working with The Financial Services Roundtable to educate the members of the Government Affairs Committee on the impacts of the CTA.
- **ECP Working Group** (Chaired by John Beran, Comerica) – This group promotes ECP implementation in the financial services industry. A CEO-to-CEO letter will be finalized soon. An ECP Forum for mid-sized and smaller institutions is scheduled for March 19 in New York City.
- **Check Safekeeping Working Group** (Chaired by Charles Siegmann, Mercantile) – This group educates

consumers, business people and Members of Congress on the benefits of electronification, truncation and check safekeeping. The group's goals include developing tools for internal education and coordinating existing information.

- **Payments Framework Working Group** (Co-Chaired by Janey Place, Mellon Financial Corp., and Woody Tyner, BB&T Corp.) – This group is working to identify strategic payments issues, including the benefits, economic impact, and strategic and tactical risks of the switch from paper-based to electronic payment mechanisms. This group will present recommendations to the CEOs at the April 2002 meetings in Phoenix.

- **Electronification Alternatives Payment Migration Model Subcommittee** (Chaired by Woody Tyner, BB&T Corp.) – This group is revising the *Electronification Alternatives Financial Model Overview and Technical Guide and Cost Model Spreadsheet* originally created in 1999. The new version will include scenarios for the CTA and ECP from stakeholder and financial institution viewpoints.

It is critical to reduce costs and increase efficiencies by getting paper out of the payments system. It is also important that industry organizations understand the potential impact of such changes. For example, how will check-related income be affected?

The Federal Reserve's Payments Studies

In November 2001, the Federal Reserve released results of three studies it commissioned to better understand where the U.S. payments system is in terms of electronic payments. The surveys were the first comprehensive studies of the retail payments system in more than 20 years. More than 1,300 financial institutions and 89 electronic payments processors responded to the surveys.

Although checks still dominate as the preferred form of non-cash payment, the results of the studies reveal strong growth in electronic payments. Migration of the payments system, the study concludes, is well underway. Electronic payments have been a significant force in the replacement of checks. In 1979, checks represented 85 percent of the payments market. Today, check use is down to 60 percent,

FOCUS, CONTINUED

and the trend is expected to continue. During the next few years we should see significant growth in electronic payments. In 2000, 29.5 billion electronic payment transactions—worth \$7.3 trillion—originated in the U.S.

The studies' conclusions are instructive for financial institutions as they make decisions on technology and other e-payments-related resources. According to the studies, 51 percent of checks are written by consumers. Point-of-sale and remittance payments written by consumers have the most potential for substitution by electronic payments. The majority of consumer checks go to paying bills; 20 percent are payments to other consumers. Meanwhile, nearly half of the checks that businesses and government write are income payments to consumers, including payroll, pension, expense reimbursements and dividend payments. Though competition is fierce among non-financial institution competitors, all of these areas present financial institutions with great opportunities for growth.

The Check Truncation Act

The proposed Check Truncation Act (CTA) is one way in which regulators and the financial services industry may work together to facilitate the industry's shift away from paper.

Among the legislation's stated goals are promoting the use of electronic payments, encouraging innovation in the check collection system, and avoiding burdensome regulatory and operational requirements. The proposed Act would enable financial institutions to expand the use of electronics in collecting and returning checks. The Act would also help organizations reduce their reliance on transporting paper checks. The legislation would allow financial institutions to better serve their customers because their branch and ATM networks would not need to be tied geographically to processing centers.

The CTA could also benefit consumers. Financial institutions could offer broader deposit options, extended deposit cutoff hours, more timely information and faster

check collection and return. This would allow institutions to credit deposits more quickly.

However, as written, the CTA may not in and of itself reduce reliance on paper. In fact, when checks are truncated without customer consent, the act requires the creation of an image replacement document (IRD). This document, which must be fully MICR readable, simply replaces one piece of paper with another at a different location. The IRD would be a legal substitute for a check, and most industry estimates suggest that an IRD will cost at least \$.025 an item to create, largely offsetting benefits captured elsewhere.

But the CTA on balance may have positive implications for the payments system. It would remove certain legal impediments to check truncation, making electronic truncation of checks easier in the collection or return process. Substitute checks, with front and back images of paper checks that can be returned to customers in place of the original, enable truncation even without a specific customer agreement.

In September 2001, BITS and The Financial Services Roundtable jointly submitted revisions to the proposed CTA. Revisions were made in drafts circulating at the time primarily to ensure that the burdens of the legislation do not outweigh its benefits. Both organizations are also concerned that the legislation may be limited to substitute checks, and not apply to existing agreements governing electronic checks. The Federal Reserve forwarded the proposal for the CTA to Congress in December, and the Roundtable is continuing its work with other industry leaders like ECCHO to ensure that the final legislation is acceptable to the industry.



Aggregation Services

The Aggregation Working Group is producing an RFI for distribution to vendors and other solution providers interested in submitting specifications to the group's data feed and authentication requirements. These solutions must meet the high-level business requirements developed and vetted by the Working Group over the course of its Phase II efforts. The Working Group is also finalizing a risk matrix designed to assist in the analysis of data feed and authentication solutions by illustrating the reduction in risk offered by more secure alternatives to screen-scraping. Subgroup conference calls are being scheduled on an *ad hoc* basis in order to meet participant needs and deliverable deadlines. Contact Leslie Mitchell, leslie@fsround.org or Gary Roboff, garyroboff1@aol.com.

*Aggregation Services Working Group
Chair: Gayle Wellborn, Wachovia*

Authentication

The Authentication Working Group has held several meetings of the Cross Industry Authentication Working Group. The group is committed to facilitating cross-industry cooperation and agrees that online authentication is the key foundation capability for e-commerce. The group is focusing on the various emerging business models and their impact on the financial services industry. Participants are also examining the need for adequate security, privacy and interoperability—both technical and operational—including gaining clarity regarding shared liability associated with cross authentication. Contact Jennifer Dickerson, jennnd@fsround.org

*Authentication Working Group
Co-Chairs: Dan Schutzer, Citigroup
Bill Randle, Huntington Bancshares*

B-to-B E-Commerce

In the Working Group's December conference call, participants narrowed their focus to a common deliverable on the information services or payments sections of the trade finance chain. The group will also pursue education on private and public exchanges to better understand how these organizations rely upon, and might be better served by, the financial services industry. The next conference call will be scheduled in February. Contact Leslie Mitchell, leslie@fsround.org

*B-to-B E-Commerce Working Group
Co-Chairs: Rodney Chard, Whitney National Bank
Peter McNally, Assurant, Janey Place, Mellon*

Business Method Patents

The Working Group has developed an educational position paper concerning complexities associated with business method patents. The document is available to BITS members and can also be accessed in the Members Only area at the BITS website, www.bitsinfo.com. Contact Cheryl Charles, cheryl@fsround.org

*Business Method Patents Working Group
Co-Chairs: Mark Kessler, J.P. Morgan Chase & Co.
David Schreiber, Citigroup*

Consumer Privacy

Results of the second year of the BITS BAI Consumer Privacy Research are being analyzed. Telephone interviews with 1,000 consumers and 1,000 additional online questionnaires are complete. This research is designed to track the effects of security and privacy issues on consumers' financial transactions. Most important, the study allows changes in consumer behavior to be tracked over time. A Working Group subcommittee continues to analyze various consumer privacy-enabling technologies. The W3C has responded to a comment letter BITS submitted concerning the P3P specification. The subcommittee is analyzing the W3C's response and will offer additional comments for consideration. BITS' letter and the W3C's response can be found at the W3C website, www.w3.org

Contact Cheryl Charles, cheryl@fsround.org
*Privacy Working Group
Interim Co-Chairs: Enid Miller, Mellon
Mary Jones, FleetBoston
Privacy Enabling Technology Working Group
Chair: Leigh Williams, Fidelity*

Electronic Signatures and Documents (E-SIGN)

Members of the Working Group are sharing ideas for implementing electronic records and delivery. During January, several FFIEC regulatory agencies' efforts were discussed. The FDIC Division of Compliance and Consumer Affairs has begun a study on bank use of electronic disclosures and signatures in other consumer transactions. This project, expected to be completed in February, is intended to research the technologies and practices used (or expected to be used) to facilitate use of electronic disclosures and signatures. The E-Banking subcommittee of the FFIEC Compliance Task Force is in the process of revising the *1998 FFIEC Guidance on*

UPDATE ON BITS INITIATIVES, CONTINUED

Electronic Financial Services and Consumer Compliance

The next meeting will be held on Feb. 15. Contact Jennifer Dickerson, jennnd@fsround.org

E-Signatures and Documents Review Group

Chair: Louis Rosenthal, ABN AMRO

Financial Services Security Lab

Information about the *BITS Tested Mark* product certification program, including new operating procedures and highlights of the program, is now posted at the BITS website, www.bitsinfo.org. The Committee began a project last month with Science Applications International Corporation (SAIC) to translate the product security profiles into security packages under the Common Criteria schema. Once complete, technology companies can test security requirements for BITS certification as part of the Common Criteria testing process. Testing is available for applications, authentication systems, access control and administration systems, application security products, network security products and monitoring and intrusion detection systems. Contact Laura Lundin, laura@fsround.org

Financial Services Security Lab

Co-Chairs: Bill Sentenac, Wells Fargo & Co

Eric Guerrino, The Bank of New York

Fraud Reduction

The Fraud Reduction Steering Committee's Working Groups continue to focus on refining the financial services industry's responses to fraud risk in the face of the payments system's evolution. The Debit Card Working Group will begin tracking offline point-of-sale losses in February, as categorized on the metrics reporting form. These data will be used in the ABA's 2002 Deposit Account Fraud Survey to assess, for the first time, the scope of offline debit card fraud. The Statistics and Successful Strategies Working Group's Truncation Task Force will complete its research for the first phase of a study of check fraud mitigation in an electronified environment. The Internet Fraud Working Group held a kickoff meeting on Jan. 25. The Database Working Group continues to hear vendor presentations on negative employee databases for applicant screening. The Steering Committee will hold an in-person meeting Feb. 28 to Mar. 1. Contact Robin Slade, robin@fsround.org

Fraud Reduction Steering Committee

Co-Chairs: Shirley Inscoe, First Union – Wachovia

Bob Jones, FleetBoston

Information Technology Service Providers

The Working Group continues to work with members of The Financial Services Roundtable and financial and technology associations to educate all stakeholders on the *BITS Framework for Managing Technology Risk for Information Technology Service Provider Relationships*. As part of this effort, BITS hosted the IT Service Provider Forum on Feb. 6, and speeches will be given at the RSA, BAI Transaction and IBG Global Payments conferences. The Working Group now has two subgroups, which are evaluating vendor management best practices and security assessment requirements for adherence to industry, regulatory and *Framework* requirements. Contact Faith Boettger, faith@fsround.org

IT Service Providers Working Group

Co-Chairs: Sharon O'Bryan, ABN AMRO

Jim Dempster, Metavante, Viveca Ware, ICBA

Insurance in E-Commerce

The National Institute of Standards and Technology and the National Security Agency, under their National Information Assurance Program, have been exploring with insurance companies the idea of establishing a working group to define security criteria and requirements, which organizations will need to have in place in order to qualify for a cybersecurity or IT-related insurance policy. At a meeting in December, the group discussed the need to understand and leverage existing criteria development efforts from public and private perspectives. A recent conference call included a briefing on the Terrorism Risk Protection Act. Work continues on developing an analysis tool for gaps in traditional insurance policies for cyber-related events. Contact Laura Lundin, laura@fsround.org

Insurance in E-Commerce Working Group

Chair: Jeff Grange, Chubb

Mobile Financial Services

The Mobile Financial Services Working Group has reviewed all comments on the *BITS Mobile Financial Services Business and Technical Guidelines*. Telcordia is incorporating the comments into the document. BITS staff is cooperating with the National Communication System (NCS) to address financial services industry emergency response needs. The NCS has been directed by the Executive Office of the President to make

Update on BITS Initiatives

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the cellular telephone Wireless Priority Service available for use during emergencies, which provides a high call completion rate when cellular telephone networks are congested. This service will likely support the government and related industries' security and emergency preparedness missions. Contact Jennifer Dickerson, jenn@fsround.org

Mobile Financial Services Working Group

*Co-Chairs: Kathy DeWit, Wells Fargo
Sam Phillips, Bank of America*

Payment Strategies

The Steering Committee's Payments Framework Working Group updated the BITS Board in January on efforts to better understand economic risks and opportunities as the industry moves from paper to electrification. Results of the study will be presented in April at the BITS Annual Meeting. The CTA Working Group has been participating with the Financial Services Roundtable Government Affairs Council to provide information for the Roundtable's lobbying efforts on the CTA. The ECP Working Group will be holding a Forum in March. Contact Gary Roboff, garyrob1@aol.com, or Robin Slade, robin@fsround.org

Payment Strategies Steering Committee

Chair: John Beran, Comerica

Security and Risk Assessment

The Security and Risk Assessment (SRA) Executive Committee met in Phoenix on Feb. 5 to set priorities and create an agenda for 2002. The National Strategy Working Group is revising the draft National Strategy document, which will then be submitted to the Treasury Department and CIAO.

The Crisis Management Working Group continues to work with CIAO and the Office of Cyberspace Security to develop our sector's critical infrastructure protection strategy. Information exchanges continue on a biweekly basis. Messages have been developed to help maintain public confidence during a crisis, and are being used with scenario-building to ensure messages are consistent. Scenario-building efforts are progressing, and CEO-level communication networks are in place. Contact Peggy Lipps, peggy@fsround.org, Jennifer Dickerson, jenn@fsround.org or Laura Lundin, laura@fsround.org

Security and Risk Assessment Steering Committee

Chair: Rhonda MacLean, Bank of America

Standards

The Steering Committee met in January to discuss ways to call the economic impact of standards to the attention of CEOs. The group also discussed engaging key standards groups, and identified groups to be included in initial outreach efforts. BITS will seek reciprocal memberships where appropriate and encourage attendance through members where none exists already. The group also discussed ways to involve key third-party vendors in the technology council. The group will host a symposium to develop a financial services glossary of terms in May. Contact Gary Roboff, garyrob1@aol.com.

Standards Steering Committee

Chair: Dan Schutzer, Citigroup

MEMBERSHIP UPDATE

We are pleased to welcome **Legg Mason, Inc.** as a new member of The Financial Services Roundtable and BITS. Based in Baltimore, Legg Mason is a financial services holding company that provides securities brokerage, investment banking, asset management and commercial mortgage banking services.

Please contact Ann Patterson, ann@fsround.org for more information about BITS membership.

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John R. Beran is Executive Vice President and Chief Information Officer for Comerica Incorporated, where he also is a member of the Management Council and Bank Board of Directors. Mr. Beran is responsible for the operations and technology of Comerica's Service Company, including electronic services, technology planning and Internet and payment systems strategies.

This is one of a continuing series of interviews with members of the BITS and The Financial Services Roundtable Boards of Directors, BITS Advisory Group, BITS Council and other key leaders in electronic commerce and financial services.

BITS: What are some of the most pressing issues the financial industry faces as we move from paper to electronic payment systems?

Beran: In this time of transition it is critically important that the financial services industry understands the impact of the changes that are underway. Financial institutions have years of processing experience with paper. As we move to electronic, with its varied forms and alternatives, we need to understand how revenues will be affected both in traditional and new payments areas. On the cost side, infrastructures are in place for paper. We need to know what electronic infrastructures will cost us.

At the same time, we need to promote the overall market acceptance of alternative payment systems among consumers, merchants and corporations. With all three, we need to understand barriers to acceptance of electronic payments, as well as what in the current process they're unhappy with.

BITS: What is your position on the proposed Check Truncation Act (CTA)?

Beran: The CTA is the first significant legislation that promotes the implementation of electronified systems. It's a good first step, and it's good that we have the attention of regulators.

Still, the CTA doesn't go where we need it to go. As written, the legislation adds costs and doesn't provide a way to eliminate the paper check. Regulators are requesting that financial institutions have check imaging available, but still be able to produce a paper check. We end up having to bear the cost of both systems.

BITS: Where do we go from here?

Beran: Although there is a lot of activity, we're very early in the process of moving to an electronic payment system. The most important thing right now is to educate lawmakers on the benefits of electronic payments technology. The education process is critical.

The CTA Working Group is very focused on that legislation. We're aligned with The Financial Services Roundtable and other industry groups like ECCHO as we seek a unified voice for the industry on this issue.

BITS: What progress is being made in Electronic Check Presentment (ECP)?

Beran: We're working to fulfill the vision of ECP. We've been successful in getting most major banks engaged in ECP, and there is a major opportunity to get deeper. We also need to get medium-sized institutions on board.



*John Beran
Comerica*

BITS: What about competition in the payments environment?

Beran: The financial industry built and paid for most of the payments infrastructure. Many non-financial competitors take advantage of that infrastructure without having to make that investment. Competitors have in many cases successfully disintermediated the process.

As an industry we've missed some opportunities. Credit card merchant processing, for example, is largely done apart from financial institutions, even when our name is on the card. Financial institutions created credit cards and then sold much of the processing infrastructure to third parties. Those third parties now control the major "rails" and deal directly with bank customers.

Payments is an area where there is day in and day out contact with customers. Senior managers need to better understand the impact payments have in two areas: profitability and customer relationships. Without a better grasp on this, our profitability erodes and our non-financial competitors gain ground.

BITS: What's the good news?

Beran: We still have customer trust. We're still the best when it comes to efficient, effective and secure services for transacting payments. Now it's a matter of converting those into the new electronic alternatives. There are opportunities as well as threats. The BITS Payment Strategies Steering Committee is working to help us understand and make strategic decisions as the payment system evolves.