



Deposit Insurance and Consumer Protection for Mobile Financial Services

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Participants

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Male:

Hi. My name is Mark Egerman. Thanks for being here. For those listening online, thanks for listening; I will try not to be too animated, so you're not missing much.

I work at the Consumer Financial Protection Bureau. We're about a 14 – 15 – a little more, like a 16-month-old agency at this point, that we were created by the Dodd Frank Act and we are still sort of getting underway trying to sort of restructure how the United States at least regulates consumer protection laws. I work on the Cards team, which is one of our operative markets divisions within a regulatory body, and as Maria said, that I'm responsible sort of bureau-wide for emerging technologies and mobile payments.

I will say at this point in the United States it is far too soon for the government to sort of be barreling into this space and deciding what will or will not be allowed and how we're going to regulate this. It's just it's a growing field, it's happening now, there are people using mobile payments in the United States, millions of people, but we have no idea if any one of these services is actually going to take hold. And for the government to start picking winners or for the government to start barring practices is probably not going to serve consumers or the market well.

At the same time, I think it would be a huge mistake for us to sit on our hands and just wait to see what happens and let bad practices develop and then become instantiated and then become sort of, you know, sort of become central to a payment technology, which would be then very hard to dislodge. So because of that we're having sort of not just a wait-and-see, but sort of tentative steps into this space. And what I'm going to talk about is what we see at the Bureau, or specifically what I see at the Bureau as likely paths for mobile technology to take from a technical perspective with reference to existing consumer laws and how there is some conflict here, whether certain implementations pose bigger threats than others, and that what we think are sort of likely to develop and how we can nudge and sort of direct that away from some of the worst practices.

So first up I'm going to give a very brief overview of consumer protection law at the most general level. Now there are differences from country to country all over the place and these are reflective of many things, including underlying payment networks. Right? So if you have a country that does real-time transaction clearing you're going to have very different overdraft protections than a country like the United States, which does batch transaction clearing. Given all of that, this is sort of how we generally look at things. We look at first up disclosures at both account opening and at the purchase step; do consumers have the information that they need to understand how much things are going to cost, what fees and

rates they're going to be paying, and whether or not they have regular or monthly statements, billing statements, things like this. We look to see the disclosure of information. Furthermore, disclosures not only include opening, but any changes. So if your fees change, if your rates change do consumers know that and do consumers have the ability to understand what the charges will be?

We then look to safety and storage, and I'm obviously not going to talk a lot about the FDIC because we have somebody here who actually can do a much better job than that. But safety and storage means when your funds are in an account are they safe. And it's not just are they insured, but also can your balances, if you have a credit product, be repriced. So if you used a credit card at 9.9-percent and you charged \$1,000.00 is the next day that balance going to be raised to 29.9-percent and you'll be paying something different than what you thought.

We look at freezing and offsetting funds. This is actually a big deal for low-income consumers worldwide, which is that if you have multiple accounts at a financial institution can they just take money from one when you owe them money from another? This is a huge problem in the United States; it's a huge problem just about everywhere.

We also look about unauthorized access. If your funds are sitting somewhere and somebody has unauthorized access do you have the ability to recover some of that funds? How much liability do you have? And then finally it doesn't quite make sense when we're talking about credit products we also look about how payments are applied, that when you make a payment off of your debt how much of that goes to your principal, how much of that goes to your interest. If you have multiple balances with multiple rates where do the payments go?

So then given that, we have disclosure, safety, and storage. We also have safety in transit. And this means that when you make a purchase is that secure, is your information going to be stolen from you and have additional charges made by the merchant or by a third party? Are there going to be chargeback and dispute rights if something goes wrong? Are there going to be receipts that allow you to actually verify what you paid for and so on? And then if you lose your card, if you have problems what are your protections there? And then finally, overdraft protections, which is what if you use your card or you don't have money in your account, what happens in that instance, how much do you have to pay, how do you remedy that situation? So those are the three big buckets of consumer protection law sort of generally different countries and different even states in the United States will have different levels of protection.

So given that, I'm going to quickly transition to sort of technical approaches to mobile payments. So if we call this mobile payments today and tomorrow mobile financial services, I'm going to focus mostly on payments and less on banking. Banking is increasingly common, but that generally refers to an existing bank account or other account that you have at a financial institution that you then access through a mobile phone and that you have limited functionality, whereas payments is using your phone to make a purchase or otherwise actually exchange funds.

This is happening and this is happening, for years people talked about this; about ten years ago people thought maybe Bluetooth would allow us to use mobile banking on phones; it really didn't happen. There are still some skeptics that think it won't happen, but increasingly millions of people are using this. We have products, not only the Starbucks mobile card, but we have Google Wallet that's in the market, we have some very interesting products that are coming up that are in beta testing. We have products such as Isis, which is a joint venture between T-Mobile, AT&T, and Verizon, which recently got another \$100 million of funding to implement a mobile wallet on your phones.

So we know this is coming and the question is what's going to win the day. Right? What's it going to look like? I think people have sort of a vague idea that you go to a store, you have your phone, you wave your phone, you type some numbers in, something happens. And so we're going to now try to look under the hood a bit and try to see what different models. And I'm going to sort of present what I would say three possible models that we're going to see, not just in the U.S., but worldwide.

Model one I think is very familiar to people who work in this space. We call it a general purpose reloadable card on a mobile phone. And this is an open loop card where you can load money up and then use it as a prepaid debit card. Right? So it's open loop; you can use it at multiple locations depending on the payment networks, and that the idea is that it's reloadable so that you can keep putting more money in, and that you can use a number of ways to pay with the phone. There's no sort of technological dependency on this one.

So one way you could do this is through a barcode, and this is effectively what Starbucks does in a closed loop way, where you take your phone, you load in an account, that account has money in it, you can reload it, you can spend funds. When you go to the cash register you take your phone and you hold it up and that barcode is there and they scan it and then it deducts it from your account. Increasingly we're going to see different technological forms, such as near field communication, which is an implementation of RFID tags, which are in passports now, or Wi-Fi or any number of things, SMS. There's multiple ways you can do this. But

effectively you have an account that is stored in your phone; it may be tied to a plastic card that you have, it might not be tied to a plastic card that you have. But you load money in and you spend money. There's very rarely credit programs here. The idea is this is just a stored value card that is accessed through your phone.

So if that is the first sort of model, we see this in the world, we see this in a number of places and this is a very popular way to do business, right? There's very little risk for financial institutions because they get their money upfront, and while they have to do fraud detection and all, have to worry about these things, they get money and then they slowly deduct it from accounts. Authorization is quite easy; the phones are connected to a cellular network, which means that the data will be transferred so that whoever is running these accounts can get access and so you have enough money in your account. Settlement is harder, paying merchants is actually quite hard in this system. If the merchant has a similar account you can just move money around; if the merchant doesn't have such account it's much harder to get funds to that merchant.

So that's briefly model one. I'm going to move on to model two.

So model two is sort of a very traditional wallet in your phone. And by that I mean you have multiple payment products, such as two or three credit cards, a debit card, maybe you also have one of these prepaid cards such as model one, all in the same place. And you, the consumer, choose which one that you want. Right? So you take your phone out and say, "I'm going to pay with my Citi card" or "I'm going to pay with my American Express" and then you swipe your phone or you show your barcode or you do whatever you want and then the phone transmits the correct information.

Unlike the first model, this can have a credit product. Conceivably in the United States Google Wallet, which is the first real working e-wallet, has independent credit cards. So a Citi card could be chosen from your wallet, you have an account with Citi; Google is just an intermediary. And then, you know, they do the business normally, authorization and settlement goes as-is, as if you were merely replacing the swipe of a piece of plastic with the wave of a phone, and that's the only difference to a consumer. But we would be crazy to think that that's going to stay. Right? That is the tip of the iceberg of possibilities here because there's a lot that you can do with the sort of processing and connectivity capabilities of your phone that you can't do with plastic.

I mean we always joke that like we have more power in our cell phones in this room than existed in the world when we put somebody on the moon. It's not quite true, but it's actually like fairly close. Right? Like you need

about 300 modern cell phones to hit like the worldwide computing power when we put somebody on the moon. That's incredible, right? And if you think about it, if we were using a 50-year-old payment network that Bank of America developed when they created, you know, Visa back in the '60s, we're doing something wrong. We have much more information, much more processing power, and much more connectivity and people are going to make money off of this. They're going to make money in a number of ways. They're going to have your loyalty cards and your rewards cards in there; they're going to send you coupons and they're going to send you advertising. But they can also do a lot more than that. Right? This is still just starting to get to what we have.

The way credit cards work now is you apply, you get underwritten one time and then you get a rate and then they might change it prospectively. But they could do real-time underwriting. They could give you an auction where you choose the best rate available. They could try to find information that's on your phone, who you've been calling, what you've been searching. So I can tell you if you've been calling a bail bondsman and Googling how to flee the country and you then want to take out a loan, I'm probably not going to give it to you. Right? That's probably not the best way to give a loan. How we use this information, how we model credit risk, these are all going to be changing.

And so with an e-wallet your phone then suddenly takes this new role; they store all of this information, they also get all of this information. They get all of your payment history, they know where you're going, they know what you're buying, when you're buying it, and they might start playing a more – the phone itself, the software will be playing a more active role in your credit decisions. It is conceivable that your phone recommends something to you such as, "This is the best card for you right now based on the rates that are available to you." And maybe it is the best card, and that would be phenomenal. We could give real-time information to consumers saying, "If you buy this TV for \$1,000.00 with your rates and your payment history it's going to cost you \$1,400.00, but if you put it on this card it will cost you \$1,220.00," and maybe that's true. But as we talked about disclosures, it might not be true. There might be a side agreement between the credit card company and the operating system or the e-wallet that prioritizes one card or provides information that is not entirely accurate. So these are things that we're looking at.

And then model three is called carrier billing, and this we also see a lot in the world. This is charges you make are placed on your phone bill. So the most common one in the United States has been the Red Cross SMS to Haiti. Right? So people could send a text message to the Red Cross to donate \$10.00 to Haiti, and no one thought of this as a credit product, but it was; it was just not a very interesting one. But basically you put a

charge on your phone bill for a purchase that you made previously. So you make a purchase and then it's put on your phone bill and you pay your phone bill in full.

Now carrier billing is fascinating, and I can tell you worldwide sort of phone operators and carrier networks are looking very closely at this, because right now they don't like extending credit; that's not their core competency. Almost no phone company in the world likes it when you don't pay your bill in full, right? Like they don't want to extend credit; they want it to be effectively a charge card, you use services during the month, you pay at the end of the month. That's how they want it to be. If you pay less than the full amount they get angry.

But that could change. It could change for a lot of reasons. They have leverage on you that your credit cards do not. If you don't pay your credit card bills they'll send some letters, if you wait long enough they'll send a debt collector. If you don't pay your phone bill they'll shut off your phone. And in the world in which we live for a lot of people, for low-income people, for underbanked people, for people whom this is important to their, you know, sort of means of living, that's leverage, and with leverage comes higher repayment, right?

And so extending credit in this space is something that we're going to see more and more of. There are companies working worldwide that allow you to put small charges on your phone bill and perhaps pay them off over time. And how that changes is going to be very interesting. So already you can go into World of Warcraft, which is, you know, sort of a fascinating little micro study of these things, and buy things in the game that are then placed on your phone bill, which makes sense when you're 14. Right? It makes sense because your parents might be checking your bank account, but they'll pay your phone bill in full. And whoever developed this country knows exactly what they're doing when it comes to 14-year-olds because the parents are way less likely to look at the phone bill, although with ringtones and everything that's also changing.

So given those three things, so the very broad overview, it's now important to think about how this could affect consumer protection, and I'm going to do this quickly and then move on to Chris, if we are talking about a prepaid card, a stored value card, we have to be very worried about disclosures. Right? Fees eat up a lot of funds in these accounts, and that is something that consumers don't know. When we are talking about a very small space for a screen you might not realize that every time you make a transaction you're paying \$0.25, right, that these things don't always appear. We have to worry a little bit about fund security. If the company that takes this in the United States is not a bank your funds might not be secure. I mean if I'm starting my own prepaid card program right

now, Mark's Shady Prepaid Card, Visa and MasterCard won't let me on their networks; they only let banks on their networks. But Google might let me in their wallet, you know, Verizon might let me on their phone. And you could put your paycheck into my account and I could flee to Acapulco and you've got no recourse.

And so when we talk about settlement and authorization networks, Visa and MasterCard have actually, and American Express and Discover have provided some security. But as new actors enter this space and as those traditional actors get disintermediated we have to start wondering about all of these risks, risks of disclosure. What if it tells you your fees are \$1.00, but in fact they're charging you \$4.00, and you only find out, and what are your recourses? Can you sue me? Maybe you can sue me, but maybe I'm undercapitalized. Maybe I fled the country. What rights do you have to recover your funds? If your funds are not secure when they're there what rights do you have, what happens when you're paying with your Google Wallet and they start offsetting your accounts, so they take money from your prepaid card to pay your credit bill and they don't tell you this?

And then finally, you have to worry about funds in transit. People are worried about identity theft, they're worried about handing over their phones, they're worried about losing their phones, but we also have to worry about chargeback rights, we also have to worry what if something goes wrong. Will Google stand in the same way that MasterCard and Visa will or will there be some perpetual buck-passing where Google says, "Hey, look, you've got to talk to your credit card company," the credit card company says, "Look, you have to talk to your payment network," and the payment networkers say, "Look, we haven't been in this space for two years. It's a Visa card, but Google's doing all the work, so why don't you talk to Google?"

So these are all the all of the concerns that we're facing, and each of the three models I laid out have very different implications for where we're going to prioritize and what we're going to do. If we're talking about carrier billing, these are gigantic corporations. I mean Verizon is humongous. They already have relationships with consumers, they have monthly payments set up for just about everyone on their system, whether it's prepaid or whether it's an open account. How do we deal with the fact that they've never been traditionally regulated as a depository institution? They don't have a compliance department anywhere like Citibank has a compliance department, and it takes years of getting used to these things. But we don't have years; this might just happen. And so building out a system that can protect against this, can see where changes are coming, and try to sort of nudge things back is what we're looking to do, and I look

forward to sort of talking about that more with questions and answers – well, questions and maybe some answers.