Nonbanks in the Payments System: Innovation, Competition, and Risk
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Session 2: Innovation
Panelist remarks
Moderator: Lee Manfred, Partner, First Annapolis
Panelist: Margaret Weichert, Senior Vice President and Strategy, Innovation and Payments Executive, Bank of America

Ms. Weichert: [remarks correspond with handout]

I am Margaret Weichert, Bank of America. First of all, I want to thank the organizers of the conference for including us in this conversation. It is an excellent topic and something I have been thinking about a lot over my career looking at payments system innovation. I have been an entrepreneur. I have worked with large nonbanks. I have worked with associations, and now I work for a bank, which probably many people would have never predicted. I have come to appreciate the different players in the payments system. The different types of players have different roles to play and are quite good at doing different things around innovation. I really see innovation in this space as a continuum that is constantly evolving. It does not reach a destination.

I would like to share a few thoughts of how we at Bank of America think about payments and payments innovation. I will start off talking about why it is so important to think about payments and payments innovation as banks.

For a long time, even the notion of payments was not something that was popularly thought of. We thought about lines of business; we thought about loans and demand deposit accounts; and payments were cash, check, wires—this was “plumbing” that was expensive and complex, but it was plumbing that was a necessary evil for the purpose of getting demand deposits and then making loans.

Over time, a lot of banks have come to realize that a critical part of the value we provide in the economy itself is payments-related. So, it is this transaction processing capability that allows us to generate the largest portion of earnings as banks. I have some McKinsey numbers that are really interesting because it is not how we report our financials, but, in fact, increasingly a lot of banks like ours are starting to think about payments as a business system.

The third page of my handout tries to lay out what I view as the critical challenges around innovation and payments. A payments system is complex. Each payments system in each part of the world has evolved over a very long time to respond to specific historical factors and specific economic factors. Bronwyn will mention the notion about demand deposits and safety and soundness being critical concepts in the United States, really driven out of the U.S. experience in the Depression. Because all these factors have evolved differently in different payments systems, there are so many diverse players who need to be part of any change to those payments systems. Innovation creates some challenges. So, we have costly and fragmented payments infrastructure in the United States. Europe is seeing the same thing. The “chicken-and-egg” problem is the classic payments challenge. I believe that we have a whole lot more complex problem than just chicken-and-egg. We have to deal with “farmers” and “tractor manufacturers” too. There are so many players who have a stake in any change to the payments system.

Safety, soundness, and security. Payments system innovation is not like making iPods. I understand that iPods are cool and important, but the economy does not stop if the iPod does not work. So, the criticality of this sector is important. A lot of people have touched on this classic innovator’s dilemma. The incumbents in this space, particularly large, heavily regulated banks, do not get rewarded by their shareholders for “bribing” people $10 to adopt a new, unproven technology. That is not how our shareholders want banks to spend their money. So, we are probably more likely to come up with incremental innovations. But I would say that the challenge for us as bankers is to not be complacent about that and to still try to come with disruptive-type capabilities like the credit card, which was a business model innovation.

Bottom line in this space, we believe sustainable innovation needs to add material, enhanced value to multiple players in the payments system, meaning it is not enough to have a technology disruption. You have to be able to meet a real need that is unmet today in a better way. So, mobile telephone technology is a great, really interesting technology capability that will only drive sustainable innovation when it is meeting needs that are not well-met today. I believe it will happen, but there are so many technology players leading with technology today. What gets lost a lot in the innovation discussion is, What problem are you solving? What are you doing that really is better? I think Internet bill payment and PayPal are examples where companies are doing something better for customers. But for point-of-sale payments innovation, I think the jury is still out, at least in the United States.

The material value proposition needs not to be just for consumers and merchants and financial institutions, but it also has to be for all of the companies who support the system from a technology perspective or from a service perspective. So, if you think about the complexity of the point of sale, you have independent sales organizations (ISOs) and you have value added resellers (VARs) and you have the people who come and fix the terminals. You also have First Data's TASQ organization that gets the terminals out there to begin with. You have a whole ecosystem that has evolved around supporting the point of sale. For something to truly replace it, it has to address that broader ecosystem.

Nonbanks can play a very special role in innovation. They can focus on smaller markets. They are, in fact, rewarded for “bribing” customers to try new technologies. They have the ability to think differently and not be punished in a lot of cases by shareholders for “blowing up” existing models. And they are less invested in the status quo. These are all pretty obvious things.

We have also talked a lot about the challenges in risks. Unclear regulatory oversight, probably PayPal is a great example. In the early days of their business model, it was not clear what types of regulations they needed to comply with or what types of rules they needed to comply with. There was a lot of heavy lifting done and a lot of responsible work done by PayPal. There are other places we can see, particularly in underserved segments like payday lending and elsewhere, where in trying to serve the unmet need of underserved populations, some players are maybe not as responsible at trying to protect the consumer and trying to keep risk out of the system.

The last thing I want to share is our approach as a bank to innovation. Bank of America has this notion of an innovation pyramid. Entrepreneurs are great at going after flashy objects at the top of the pyramid and straight to the heart of disruptive innovation. Large nonbanks, like CheckFree and First Data, are great at reducing complexity and reducing fragmentation in the system and driving scale, focusing on the bottom of the pyramid. What we as a bank at

Bank of America are trying to do is integrate across all of these things to be a low-cost provider to achieve scale and efficiency so we can serve our existing customers better, faster, and cheaper around innovation.

I will leave as a parting shot (and we will have a lot of opportunity for dialog about specific innovations) that a place where I am spending a lot of time thinking about innovation is in that underserved segment. We have talked a lot about technology innovation, but the place where I actually see a huge set of unmet needs that prepaid cards and payday lenders and money transmitters are serving is the population that has real financial services needs that we as banks have not been able to get to and profitably serve. Anything that is about cash replacement is something we are watching very closely and looking to see what insights about the customer need can we learn about as bankers, so that we can, in fact, meet that need and do it responsibly and obviously make money while doing it.

Those are the comments I was planning to make, and I am happy to turn it over to Lee.

Mr. Manfred:

Great. Let me ask you just a couple of questions. Do you believe that nonbanks have an advantage over banks in innovation generally or only in those more disruptive innovations?

Ms. Weichert:

I think there are some advantages, particularly for smaller, nonpublic companies, of really "blowing things up." If somebody is a Bank of America shareholder, they bought a *bank's* stock. They did not buy a high-growth, technology-company stock. That shareholder can diversify their portfolio in a lot of different ways. If you are a privately held startup, a VC can help fund you and diversify their portfolio in a variety of ways. A lot of the advantages about how disruptive you can be to the status quo relate to some of those of ownership. I would say they extend not just in disruptive innovation, but also in incremental innovation.

Mr. Manfred:

Can you share a little bit about how you think about the implications of these derivative payments innovations, like Google Checkout and PayPal, that rely ultimately on legacy clearing and settlement systems? How do you or Bank of America in general think about these issues strategically?

Ms. Weichert:

Well, competition is a wonderful thing. Having a little bit of fear about them stealing my business hopefully makes me work that much harder to provide a superior value proposition, such that they do not leave banks with all of the cost of servicing the customers and answering the telephone calls. Have you ever tried to find a telephone number on PayPal.com? Try that. I am motivated to make sure I am not stuck with all of the expensive parts of servicing the customers and become disintermediated around the customer relationship. That is a healthy thought process, and I feel as long as we as bankers keep meeting the needs of our customers, they will keep coming to us. If we do not, shame on us. That may be a different point of view than other folks may have, but we at Bank of America call it “positive paranoia.”