Order Code RS20509
Updated April 28, 2000

CRS Report for Congress
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Trends in the Financial Services Industry: Online Banking and Payments

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Summary

The variety and number of banking and payments services being offered over the Internet are growing. Legislative and regulatory interest is increasing concomitantly. These new technologies present new opportunities and new risks. At present, legislators and regulators are assessing what adaptations may be necessary as functions formerly carried out in a paper-based environment switch to electronic format, and what actions might facilitate orderly development. This report will be updated as events warrant.

Current Developments

Many means of effecting electronic financial transfers have been developed in the United States and globally over the past three decades. Private sector developments leading to new and innovative electronic banking products are drawing renewed attention today. The expanding banking and payments services offered over the Internet are of special interest.

Concomitantly, legislators, regulators, and the Administration are looking at whether regulations and statutes need to be changed to facilitate developments. Representative actions include the following.

- Legislation (H.R. 1714, S. 761) that would enable legal recognition of electronic signatures in interstate commerce is pending in Congress.[1]

[1] See CRS Report RS20344, *Electronic Signatures: Technology Developments and Legislative Issues*, by Richard M. Nunno. There, electronic signatures are defined as "methods used to provide *electronic authentication*, a process of verifying the identity of users of a computer ... in order to control access or authorize transactions."

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- The Federal Reserve is considering proposals to allow electronic delivery of federally mandated disclosures.[2] H.R. 2626 would amend certain consumer protection laws to facilitate the electronic delivery of disclosures and other information.

- In reviewing its regulations, the Office of the Comptroller of the Currency (OCC) has asked for public comment on a wide range of issues concerning national bank involvement in Internet-based activities and other emerging electronic technologies.[3]

- The major financial services legislation enacted in 1999 (P.L. 106-102, the Gramm-Leach-Bliley Act) stipulates that federal regulators are to study and report on adapting existing legislative requirements to online banking and lending.[4] This study is due before November 12, 2001.

- The Administration has undertaken recent initiatives to protect computer systems from hackers and viruses, and to identify laws and regulations that impose barriers to the growth of electronic commerce and consider how they might be revised.[5]

Why the renewed interest now?

Until now, the most recent widespread examination among legislators and regulators of electronic banking occurred in the 104th Congress.[6] Financial institutions were exploring online banking and payments services at that time, but such services were not

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[2] The Board of Governors of the Federal Reserve System in March 1998 issued proposed rules (and an interim rule in one case) for several consumer protection regulations. Modified proposals were issued August 18, 1999. On December 9, 1999, the comment period was reopened and extended to obtain additional views from individual consumers, primarily through focus group interviews. The press releases and attachments are available on the Fed's Web site: [http://www.federalreserve.gov].

[3] U.S. Department of the Treasury. Office of the Comptroller of the Currency. Electronic Banking. *Federal Register*, February 2, 2000 (Vol. 65, No. 22), pages 4895-4897. The OCC is the primary federal regulator for national banks. More information can be found on the Internet banking section on the OCC's web site [http://www.occ.treas.gov/netbank/ebguide.htm]. The *Comptroller's Handbook for National Bank Examiners, Internet Banking Handbook* is included there. It is designed to provide guidance to bankers and examiners on identifying and controlling the risks associated with Internet banking activities.

[4] P.L. 106-102, Section 729.

[5] Information on recent initiatives is available on the web site on "United States Government Electronic Commerce Policy" maintained by the U.S. Department of Commerce [http://ecommerce.gov/].

[6] The most extensive set of hearings in the mid-1990s was that of the House Committee on Banking and Financial Services, Subcommittee on Domestic and International Monetary Policy. *The Future of Money*. Hearings, 104th Congress, 1st and 2nd sessions. 4 parts. The Congressional Budget Office also published an extensive study in 1996: *Emerging Electronic Methods for Making Retail Payments*.

immediately embraced by customers. Financial institutions then and now would have varied reasons for developing these services: lower costs and increased market share among them.

Why did customers not press for more online services earlier? That is widely attributed to the highly developed system available in the United States to deliver financial services apart from online services. Existing arrangements have made other new forms of services less pressing. Financial providers have extensive physical facilities and ATMs (automated teller machines) where banking business may be transacted. Payment mechanisms in wide use in the United States include cash, the paper-check system, credit and debit cards, and the increasingly used wire transfer and ACH (automated clearing house) fund transfer systems.[7]

Today's renewed interest in online banking and payments has many roots. Increasing numbers of businesses and consumers have access to distribution devices such as the personal computer. New ways of connecting are being developed through devices such as the mobile phone. These are just two examples. Customer demand is picking up as a result. Complementary uses by customers also encourage the development of electronic financial services. Other forms of e-commerce can be enhanced by the availability of electronic payment systems, for example.[8] At the same time, customer satisfaction with online banking has been less satisfactory than with other online services such as online securities trading, leading to questions about how fast it may grow.[9]

What is happening in the marketplace?

Many kinds of experiments in electronic services are occurring. In some cases, financial institutions are using online services to complement existing products which continue to be available in the traditional "bricks and mortar" settings. In a few cases, banks are operating in a totally online environment.

Institutions differ in the extent to which they are making banking services available electronically. The Federal Deposit Insurance Corporation indicates that as of year end 1999, some 4000 insured banks and thrifts had a presence on the Web. Many institutions offered information about themselves on these sites, but did not offer transaction services online. Banks and thrifts maintaining secure sites on which customers could view account information, transfer funds between accounts, and/or pay bills numbered about 1,250 as

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[7] For a recent overview of electronic services, see Weiner, Stuart E. Electronic Payments in the U.S. Economy: An Overview. *Federal Reserve Bank of Kansas City Economic Review*, Vol. 84, No. 4, Fourth Quarter 1999: 53-64. In June 1997, the United States General Accounting Office published the study, *Payments, Clearance, and Settlement. A Guide to the Systems, Risks, and Issues*, GAO GGD-97-93.

[8] For background on electronic commerce, see CRS Report RS20426, *Electronic Commerce: An Introduction*, by Glenn McLoughlin.

[9] For a critique of several online banking services, see Rose, Sarah. The Truth About Online Banking. *Money*. April 2000, p. 115-122.

of February 2000. More instant credit decisions are currently becoming available online either for credit cards or personal loans.[10]

Services being rolled out to facilitate online payments are attracting increasing attention. New online payments options are being offered customers by bank and non-bank providers. What distinguishes them from earlier services is that they emphasize online payments "person-to-person." Online credit card payment innovations provide for consumer-to-consumer transfers. They expand on available business-to-business payments services, and extend credit card use beyond the familiar business-to-consumer usage. E-mail payments mechanisms are also expanding.[11]

Policy Issues

Use of most electronic environments is affected by the attributes surrounding that environment: security measures, privacy policies, and access, among them. These policy issues of general concern in an electronic environment take on special significance when dealing with individuals' finances.

CRS Report 98-67 and CRS Report RL30322 are among the CRS products applicable to Internet usage. The first report deals with issues affecting the use and growth of the Internet including encryption, electronic signatures, computer security, and Internet privacy, which affect electronic banking.[12] The second deals specifically with online privacy protection.[13]

This discussion has dealt primarily with traditional banking services: savings and payments, and loan applications, for example. Related services includes investing and trading in securities, whether through bank-related or independent securities-market channels. Individual use of online trading facilities has grown faster than banking services. The development of electronic trading systems and the "computerization" of the stock market is related. CRS Report RL30195 addresses that development.[14]

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[10] Information from FDIC, telephone conversation, March 9, 2000.

[11] Fickenscher, Lisa and Megan J. Ptacek. *On Internet, Next Wave for Banks Could be P-to-P.* American Banker, April 27, 2000, pp. 1, 14, 16.

[12] CRS Report 98-67 STM, *Internet: An Overview of Key Technology Policy Issues Affecting Its Use and Growth,* by Marcia S. Smith, Richard M. Nunno, John D. Moteff, and Lennard G. Kruger. A relevant study issued in July 1999 by the United States General Accounting Office is *Electronic Banking. Enhancing Federal Oversight of Internet Banking Activities.* GAO/GGD-99-91.

[13] CRS Report RL30322, *Online Privacy Protection: Issues and Developments,* by Gina Marie Stevens. The CRS Electronic Briefing Book on Banking and Financial Services has an entry on *Privacy Protection for Consumer Information*, by M. Maureen Murphy at [http://www.congress.gov/brbk/html/ebfin1.html].

[14] CRS Report RL30195. *Alternative Trading Systems: Will Computers Replace Stock Exchanges?*, by Mark Jickling. The Senate Banking Committee began a series of hearings in February 2000 on the "Financial Marketplace of the Future." These hearings address the regulatory and structural environment for the changing securities markets

(continued...)

As outlined above, financial regulators are actively considering regulation appropriate to the traditional functions being adapted to new technologies, as well as the new kinds of applications that technological innovations may inspire. These new technologies present new risks as well as new opportunities, and raise questions about user protection.

If a major problem were to develop for existing users of electronic banking services, for whatever reason, more active public policy debate in the area would likely ensue. Otherwise, the issue area is likely to grow concomitant with the growth in use of electronic banking facilities in the United States.

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[14] (...continued)
[http://www.senate.gov/~banking/hearing2.htm].