**Payment Systems Introduction**

Welcome to this podcast on Payment Systems Introduction brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is the basic concepts related to payment systems. In particular, we will introduce some of the payment systems, many of which you probably use regularly. So, how do we pay for things? What did you buy last and how did you pay for it? It should not surprise you that there are many ways to pay for goods and services, both cash and non-cash systems. While cash is widely accepted, you might ask yourself whether you typically pay for items you buy in cash. Recently, I encountered a taxicab driver who strongly insisted that I pay for my trip to the airport with cash and discouraged my paying with a credit card. Why might the taxicab driver prefer cash? Why might I prefer to pay by credit card? An understanding of the basic issues of payment systems will help you to know more about the choices that you make with payment systems, and what might motivate others.

Certainly there are cash and non-cash payment methods, but there are also paper-based and electronic-based systems as well. Examples of non-cash paper-based payment systems include checks and promissory notes. Examples of electronic-based payment systems include credit cards, debit cards and ACH (automated clearinghouse) and wire transfers. It should not surprise you that electronic-based payment systems dominate both in terms of number of transactions and the value of transactions in the United States. This has been true for some period of time. According to a Federal Reserve Payments Study non-cash payments in the United States, including debit card, credit card, ACH, and check payments totaled a whopping 144 billion transactions with a value of $178 trillion in 2015.

In case you are curious, how do the non-cash systems breakdown? Debit cards have had the largest increase in transactions with 69.5 billion transactions in 2015 totaling $2.56 trillion. Interestingly, credit card transactions are fewer in number, but actually have a larger value at $3.16 trillion annually. The number of ACH transactions has also grown to a value of $145.3 trillion in 2015. The one non-cash payment method that is in decline, you might guess, is paper-based, the check. Use of paper based checks has declined for some time, but is still a significant amount of transactions with a value of $26.83 trillion annually. Taken together, these payment systems collectively form the bulk of non-cash payment systems commonly used by consumers and businesses in the United States.

You might encounter these payment systems in a traditional purchase in a face to face transaction, such as when you present your debit card to pay for groceries, but you may also see them used in new ways. For instance, Apple Pay is a newer way to pay for groceries at markets that accept it, but it is not necessarily a new payment system, as it is tied to a credit or debit card. Similarly, ACH transactions have long been used by larger entities, such as employers who direct deposit payroll for employees. However, online banking bill payment systems have now allowed consumers to tap in to ACH payments for many of their routine payments for mortgages, utilities, and the like. Perhaps you use one of these systems. Also, notice that some of these payment systems can be used in person, such as cash, checks, debit and credit cards. Yet, other payment systems such as ACH transfers are not done in face to face transactions. With the advent of Internet retailing, debit and credit cards are often now used in many remote transactions, as well as in-person ones.

You might wonder, how do retailers actually get paid, though? When it comes to cash, the use is universal and payment is immediate. Checks are not far off from cash in that a check could be presented to any individual or business willing to accept one with payment being easily obtained through the banking system. By contrast, debit and credit cards typically operate over a system, such as the MasterCard or Visa network. You cannot simply present a debit or credit card to any individual or business unless they participate in the particular network designated by the card. A merchant or individual that accepts payment requiring participation in a system get paid in accordance with the rules provided by the operator in exchange for a fee to use the system. Those who accept payment with cards do so under the assumption that customers are more likely to make the transaction, or perhaps a larger transaction, with the card thereby justifying the fee in order to accept the payment system that requires participation in a network. Remember the taxi cab driver at the beginning of this podcast? Perhaps he didn’t want to pay the fee for my use of a credit card? And, since I was already in the car bound for the airport, the transaction was a sure thing for him.

You might ask, what law applies to these payment systems? You may have encountered the Uniform Commercial Code Article 2 on sales of goods as part of a course on contracts or sales. Recall that the Code is part of state statutory law. As it turns out, the Uniform Commercial Code has many articles and, in fact, has provisions related to payment systems. These include Article 3 on negotiable instruments, Article 4 on bank deposits and collections, Article 4A on funds transfers, Article 5 on letters of credit and Article 7 on documents of title.

Other applicable law would include federal consumer protection statutes and their implementing regulations. Remember that Congress passes statutes, but the administrative agencies adopt implementing regulations as part of a notice and comment process culminating in final rules, with draft rulemaking appearing in the Federal Register and final rules appearing in the Code of Federal Regulations, commonly called the CFR. Many of these regulations can be found online. Excerpts are typically found in many statutory supplements. You may see numbering reflecting the statute itself or numbering reflecting rulemaking in your studies.

In the area of payment systems in particular, the federal Consumer Credit Protection Act contains provisions on consumer credit covering credit cards and electronic funds transfers covering debit cards. Both the Federal Reserve Bank and the Consumer Financial Protection Bureau have rulemaking authority in this area.

Absent state or federal statutes though, payment systems are typically governed by the rules set forth by the operator, such as MasterCard, Visa, or NACHA for ACH transactions. At other times, industry groups may set forth commonly adopted rules, such as the International Chamber of Commerce’s Uniform Customs and Practice for Documentary Credits that are often used with letter of credit transactions. Otherwise, the parties themselves enter into contracts that provide the terms associated with participation in the payment system. For instance, a merchant, such as your grocery store, has a contract with its bank in order to accept credit cards for payment of goods and services.

Each of the payment systems not only has mechanics for using the payment system, but also risk with respect to error and fraud. At its simplest, if you use cash and lose your wallet you bear the risk of loss and are out of luck. You might counter this risk by being more careful with your wallet or simply not carrying large amounts of cash. Each of the other payment systems has its own allocation of risk for error and loss for which participants take actions in an attempt to reduce exposure. For instance, due to an allocation of risk that ordinarily falls on a card issuers or merchants for fraud, many consumers now have debit and credit cards that contain computer microchips. The microchip cards are designed to use by inserting the card into terminals when paying in person in order to tackle the problem of counterfeit cards based upon magnetic stripes. These types of advances will continue to adapt to counter fraud across various payment systems.

At this point, you should be able to identify some of the primary payment systems in the United States along with some of the statutory and other rules governing these systems.

I hope you’ve enjoyed this podcast on Payment Systems Introduction.

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