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2020 OUTLOOK: U.S. DEBIT CARDS AND ALTERNATIVE PRODUCTS

Investment in faster and real-time payments picks up and the impact on traditional payments is already being observed.

The disruption of faster payments and real-time payments is impacting primarily check and cash transactions in these early days of adoption, but it is easy to envision a point when other traditional payment types, including debit cards, will be challenged.

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First, a Look Back at 2019

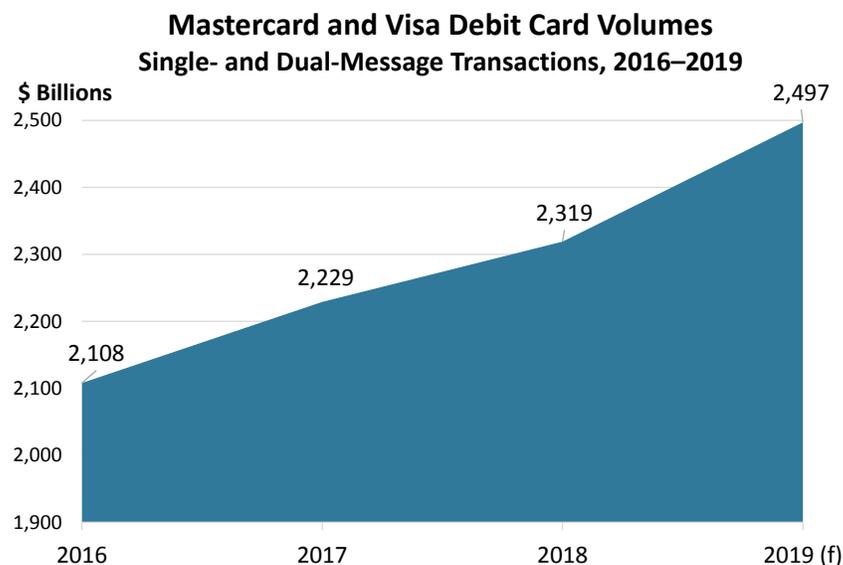
A review of last year's forecast for U.S. debit cards and alternative products as predicted in Mercator Advisory Group's 2019 Outlook reveals that most, but not all, outcomes we predicted were realized as the payments industry provided a few surprises:

- Transaction growth for U.S. debit cards was good, but not exceptional, as predicted. With only half of 2019's volumes disclosed to date, Mercator projects that debit card volumes will have picked up during the second half of this year and will grow in 2020 at a rate of 6–8% over 2019. Some of the growth achieved in 2019 was due in part to debit push payments, in which a sender can credit or “push” a transfer of funds to the recipient over the Mastercard and Visa debit networks, typically within seconds. Push payments have a much greater impact on debit network volumes in 2020.
- Contactless card issuance took off more than predicted. Much more. Large banks that saw an opportunity to convert small cash purchases at the point of sale (POS) to a monetized card transaction began to reissue debit (and credit) cards. Feeling competitive pressure, smaller banks followed suit.
- Person-to-person (P2P) faster payment solutions continued to produce steep increases in transaction volume in 2019 with continued high growth predicted in the near term. Business-to-consumer (B2C) faster payment disbursements, particularly in insurance payouts, picked up their pace in 2019 as a more efficient alternative to checks with a better user experience.
- Business-to-business (B2B) faster payments volumes grew more slowly than expected. Developing products at banks that integrate into complex user interfaces such as cash management platforms and back-office systems takes time. Businesses too need time to update their internal accounting systems to take advantage of improved data that accompanies a real-time transaction.
- The timing and approach of the Federal Reserve's August 2019 announcement of its real-time payments platform, FedNow, was definitely not predicted. Much is still unknown about the service and its potential impact as the Fed works to define how the service function and how it will interoperate with RTP, the real-time payments solution by The Clearing House (TCH), a bank-owned entity.
- The pace of merger activities of the large core and payment providers in 2019 was brisker than anticipated. Banking and payments activity and developments will now be controlled by fewer organizations. This can result in greater efficiencies, but it means less competition for product, service, and price.

The U.S. Debit Card Market in 2020

As consumer confidence declinesⁱ and credit card interest rates increase,ⁱⁱ buyers tend to be more cautious in their spending. In the past periods of belt tightening, debit card volumes have risen. People in the lower-income demographic, which favors debit cards as their payment type of choice, will continue use their debit cards for spending on everyday purchases, and they will also use their debit card for some items that under different economic conditions would be made with credit cards to avoid interest charges. Recent growth trends of Mastercard and Visa dollar volumes of debit transactions and a prediction of year end 2019 volumes are depicted in **Figure 1**.

Figure 1: Steeper growth in debit volumes to end 2019, driven in part by increased push payments.



Sources: Mastercard and Visa financial disclosures, Mercator Advisory Group estimates

Despite the higher cost of a dual-contact and contactless card compared to a standard EMV chip card, many more financial institutions in the U.S. will launch contactless debit cards as fast followers after those that announced their intentions in 2019 to do so. Not only will issuers want to be competitive, but they are also counting on contactless technology to help monetize cash transactions and create net new debit card volume. Financial institutions that receive regulated interchange will earn nearly as much on a \$10 purchase they convert from cash to a debit card transaction as they do on a \$40 debit card transaction since interchange consists primarily of a fixed, per transaction value.

Merchant acceptance of contactless cards will continue to be spotty, but more transit systems with open payment solutions that use contactless at the turnstile will encourage use, which will extend beyond rides to other

merchant locations. It is too soon to expect that contactless card activity will drive the use of in-store mobile payments as consumers develop the habit of tapping their cards at their favorite stores. That will take more time.

Mercator Advisory Group forecasts the volume of push payment activity processed through the debit card networks in the U.S. will nearly double in 2020 as consumers find more uses for person-to-person (P2P) payment apps that rely in part on Mastercard Send and Visa Direct to move funds. Businesses will use push payments rather than checks for a growing number of consumer and small business distributions.

Next, a more speculative forecast: The megamergers of 2019 laid the foundation for a new global debit network competing with Mastercard and Visa, and development of this new network will begin in 2020. The most likely candidate is the combination of Fiserv's Accel and First Data's Star electronic funds transfer (EFT) debit processing networks, which serve a significant number of debit issuers both large and small and a vast network of domestic and international merchants. Although a lot of effort is required to create a viable network, there is enough sentiment in the debit acquiring market to support a new global network as an alternative to the traditional players as long as the pricing, chargeback rights, and features are competitive. This is not just about the transaction but also about transaction tokenization, which currently is controlled through Mastercard's and Visa's payment token vault capabilities and related services.

Two other influences on the debit market:

- Competition for debit transactions from digital-only challenger banks will have some impact on debit card transactions. This trend will not affect total industry volumes but will shift a small percentage of transactions away from traditional banks and credit unions.
- Decoupled or private-label debit with attractive rewards programs will continue to grow in the fuel and convenience mart industry, with grocery stores, drugstores, quick-serve restaurants (QSRs), and other merchant categories in which debit is the preferred payment type. The impact on traditional debit volumes is still small, but Mercator expects it to grow to nearly \$20 billion in processed volume.

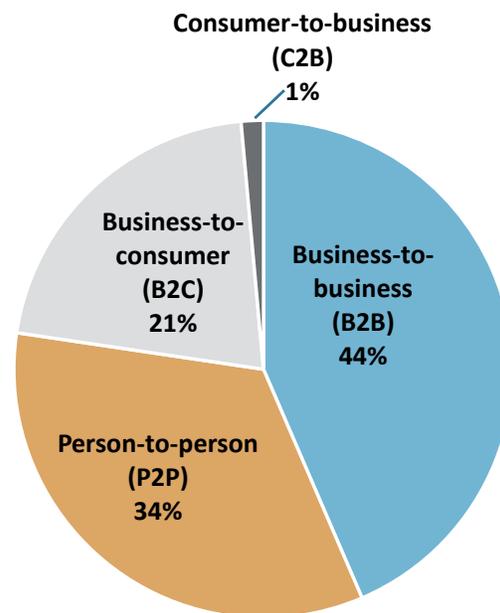
Faster and Real-Time Payments

Faster and real-time payments will consume much of the financial services market's time and investment in 2020. Organizations that committed to faster and real-time payments years ago will deploy new products with a focus on B2B and B2C transactions. The announcement in 2019 that the Federal Reserve will build a real-time payments platform, FedNow, to compete with private-sector solutions creates the need for bankers to rethink their long-term strategies. Large banks will decide whether to gear up to accept FedNow transactions (an outcome that is highly likely), and smaller banks will need to determine if they will integrate with The Clearing House's RTP solution or with FedNow or both. The major core processors and the neo-cores will be in a position to play the role of linking the two platforms through overlay products that can process both solutions and help to solve the conundrum of interoperability.

Figure 2 illustrates Mercator’s faster payments estimates for 2020 by channel, considering all market-available payment networks.

Figure 2: Mercator Advisory Group’s 2020 U.S. faster payments projections by channel

Transaction Dollar Volumes, 2020F
\$905 billion total annual volume



Source: Mercator Advisory Group estimates

The payment industry will be watching for clues indicating how the Federal Reserve will approach the development of FedNow and whether Congress will have any influence on the matter. Two bills have been introduced that aim to influence FedNow and real-time payments generally. They are H.R.3928, the Federal Reserve Accountability and Justification Act,ⁱⁱⁱ and H.R. 3951, Payments Modernization Act of 2019.^{iv} **Figure 3** summarizes their key points.

These bills are likely to have only minor impact on the current course. The Federal Reserve will build FedNow as it has planned, in the timeframe required to develop a full-featured platform including sound security measures, and checks will still settle as they do today. In the meantime, the beat goes on and the private sector will make the most of the existing faster payment solutions including same day ACH, the debit push payments, RTP, and the Zelle network and exploit their early-to-market position.

Figure 3: A summary of U.S. legislation introduced regarding faster payments

Payments Modernization Act of 2019	Federal Reserve Accountability and Justification Act
<ul style="list-style-type: none"> • Updates Regulation CC Funds Availability, to include real-time availability of funds. • Requires that checks, once deposited, be made available immediately to the depositor. • Commands the Federal Reserve System to develop a real-time payments platform which, at minimum, should provide the features and capabilities defined by the Faster Payments Task Force. • Requires that the Fed charge financial institutions a flat rate fee for all transactions regardless of size of institution. 	<ul style="list-style-type: none"> • Requires the Fed to state the reasons that would justify building FedNow. • Requires proof that the Fed can recover the cost of building FedNow. • Prohibits the Fed from developing a service that can be provided by other entities effectively and without discrimination.

Source: www.congress.gov

Person-to-Person Transactions and Business-to-Consumer Disbursements

P2P network provider Early Warning will grow the Zelle network at a pace similar to the growth that occurred between 2018 and 2019, which Mercator forecasted to be over 30% year over year. The growth will result from the stable of pending bank and credit union implementations, organic growth with existing clients, and to a lesser degree, expansion of features to serve the business-to-consumer disbursement and the small business market.

PayPal, PayPal's Venmo App, and Square Cash will also undergo strong organic growth as consumers find these apps a convenient alternative to cash and checks, and also through the use of these apps as a vehicle for prepaid payments. It should be noted that most of the transactions originating from these apps are not real time, although a faster option does exist for use when consumers wish to receive their funds more quickly into their checking accounts. The faster transaction is provided for a fee and delivered within 30 minutes through the debit push payment networks Mastercard Send and Visa Direct.

Mastercard Send and Visa Direct networks will likely announce new partnerships and solutions in 2020 that bring together the global transaction capabilities of the faster payment debit network solutions incorporating the features of their recently acquired international cross-border companies—Transfast, acquired by Mastercard, and Earthport, acquired by Visa. This will shake up the P2P remittance market by combining the nearly ubiquitous reach of the debit networks, speed, and the global capabilities that none of the other current faster payment

platforms have yet developed. Although the debit networks don't offer the transaction data flexibility of other faster payments solutions, that flexibility isn't a requirement to succeed in consumer payments.

Business-to-consumer real-time and faster transactions on all the available networks, including same day ACH, Zelle, the debit push payments, and RTP, will grow within the current use cases such as casualty and property insurance payouts, payroll, and payments to gig economy workers and freelancers (IRS 1099 workers). Newer use cases will gain traction, including higher education payments like tuition reimbursements, expense reimbursements, and healthcare payment refunds.

An area that will gain more attention in 2020, if not actual transactions, is government-to-consumer payments at the federal, state, and local municipality levels. Public sector payment processes are often complex and difficult to change, and the volume of checks used by government entities is significant. Therefore, moving to electronic transactions that don't require storing sensitive account details provides substantial cost savings as well as a better, more secure experience for governments and their citizens.

Consumer-to-Business and Request-for-Pay Transactions

Faster bill payments and other C2B transactions will undergo more implementation in 2020. This segment of the industry processes trillions of dollars annually and constitute critically important transactions for consumers. Consumers admit that they often pay their bills at the last minute and sometimes late. They are using a range of payment types to pay their billers, including checks and cash. Mastercard is launching Mastercard Bill Pay Exchange, a bank and credit union based bill-pay solution that offers options for real-time payments. TCH has built its Request for Pay (RfP) solution, and now banks that want to use this solution need to integrate it into their mobile banking capabilities. RfP will allow billers to message their customers and request payment for an outstanding bill. A customer who agrees to a biller's request responds to the message and a payment is made immediately. So 2020 will be a build-out year for these transaction types with significant growth occurring in 2021 and 2022.

What we will not see in 2020 is a C2B point-of-sale solution built on faster payments. Large banks are too dependent on the interchange model and will not want to jeopardize that revenue source. Building a large-scale alternative to the global card networks would require the big banks to have buy-in from their consumer users and merchants. While a new payment type will emerge eventually in the U.S. market, that is years away.

Business-to-Business Payments

Business-to-business transactions, which is where transaction volumes in faster payments first began to materialize, will see only tempered growth in 2020 as both financial institutions and the businesses interested in sending and receiving transactions in real time implement the technology needed. Growth will be more visible in 2022 and beyond.

Conclusions

2020 in the U.S. debit card industry will be about execution. Debit card portfolio managers will continue efforts to control product expenses given the product's thin operating margins, but investments to improve the consumer experience will also emerge. This includes investment in contactless debit card issuance and also investment in technologies like those showing up in the credit card market, including easy digital acquisition capabilities, new card activation options, upgraded card plastics, better visibility in the bank's or credit union's digital app, and other improvements as the value of debit as the proxy for consumers' core financial account is recognized.

Watching the faster and real-time payment solutions roll out in 2020 will be exciting. The solutions represent a rare opportunity to participate in the formation of a new payment type, not just a new form factor, and to get it right. Many financial institutions will lean heavily on fintech technology through partnerships and acquisitions to develop features and functionality to bring products to market. The newness of real-time payments will attract attention from legislators and regulators, so bankers will want to stay engaged on that front. Decisions made now can have far-reaching implications.

References

Related Research by Mercator Advisory Group

[U.S. Faster Payments Forecast 2019: Building the Foundation](#) (October 2019)

[Ready or Not: U.S. Contactless Debit Card Issuance Takes Off](#) (July 2019)

[2019 Annual U.S. Debit Market Data Review](#) (June 2019)

Endnotes

ⁱ <https://www.wsj.com/articles/u-s-consumer-spending-rose-sharply-in-july-11567168319>

ⁱⁱ <https://www.wsj.com/articles/interest-rates-are-falling-but-your-credit-card-rate-could-be-going-up-11571056355>

ⁱⁱⁱ <https://www.congress.gov/116/bills/hr3951/BILLS-116hr3951ih.pdf>

^{iv} <https://www.congress.gov/116/bills/hr3928/BILLS-116hr3928ih.pdf>



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