ForeSight

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Justifying Real-Time Payments In the United States

As the U.S. real-time payments solutions are launched, participants in the value chain are looking to define their roles.

The prospect of brand new payments rails in the United States has the payments industry evaluating what might be the best use cases and where the business case may also align.

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Introduction

One of the most anticipated new payment capabilities in the United States has to be the promise of real-time payments (RTP). We are talking about shiny, brand new payment processing rails—not souped-up ACH or a reconfigured wire system or enhanced card networks. The system will be all new from point of entry to final settlement.

The U.S. has been told for years that its slow, batch-based payments systems are just too antiquated and in need of refreshing to be on par with the likes of Singapore, the United Kingdom, Japan, Mexico, Nigeria, Poland, and several other countries that have already invested in a RTP platform. To that end, the Federal Reserve Board has been at work to pull together a cohesive team of industry experts to lay the ground rules and set the parameters for the functionality and security of a U.S. RTP system. The Federal Reserve's FedPayments Improvement initiative has established the fundamental features that a U.S. RTP system should include. These are outlined in Figure 1.

Figure 1: Desired Outcomes of a U.S. Real-Time Payments System

Speed	The platform should allow payment clearing and posting within seconds and with finality. The payment is to be final and immediately available for use by the recipient. Data regarding the transaction should also be available in the same timeframe
Ubiquity	Just as card networks are available nearly everywhere to nearly everyone, the same openness is expected of real-time payment platforms.
Security	The FedPayments Improvement guidelines and market expectations will demand secure systems that can meet evolving threats to its security.
Efficiency	An efficient system is necessary for continued build-out of the architecture and to keep costs low to encourage use.
International	As banks, businesses, and individuals send more transactions globally, improved opportunities for a cost-effective faster international payments option are needed. ISO 20022 is a globally recognized standard on which many of the existing RTP platforms are either built or considering adopting so that funds and data can be conducted through a common language.

Source: Mercator Advisory Group

But Is There Any There, There?

On the global payments stage, the United States is being chided for not moving more quickly toward real-time payments. The criticism is similar to the tongue lashing the country took for not moving sooner to EMV standards for card transactions. The EMV migration should be a lesson learned. When the U.S. rushed to migrate to EMV, mistakes were made. The conversion has left the industry with a black eye, has created further riffs between the payment participants, and hasn't provided much value to the cardholder despite its documented effectiveness in driving down counterfeit card losses.

So with the initiative for RTP, thoughtfulness should be encouraged to ensure that beyond building a new payments toy, the industry is building a secure system that has not only viable use cases but also encouraging business cases. Without a viable business case, building a full-feature solution that meets all of the Fed's criteria will be difficult and making investments for ongoing improvements will be difficult to justify.

The cost of building a RTP platform in the U.S. is unknown. The U.K.'s privately and publicly funded solution is reported to have cost approximately £240 ($307) million[i] spread over seven years, plus investments by each participating bank to connect to the platform, to upgrade its internal bank systems, and to maintain in an "always on" environment. Although the cost of building the platform for the U.S. may actually be less than the cost of platforms built earlier in other markets since the creators learn how to be more efficient with each RTP iteration as technology improves, the U.S. market is much more complex than the other markets, including the sheer number of financial institutions that may wish to integrate.

Also, there isn't a single, publicly funded and managed solution that financial institutions (FIs) are mandated through regulation to use. At this stage of RTP development in the U.S., there will be multiple privately developed and funded solutions. Depending on the merits of each, this may cause some FIs to consider multiple integrations. After RTP platforms are up and running, the old systems will still have to be maintained, at least for the foreseeable future. Too many entities and too many systems rely on existing payment methods for them to be retired.

Related Concerns

If you find this piece of interest and would like to explore this issue further, possible proprietary project work could be done to examine questions like these:

What is the best way to develop a strategic plan for the inclusion of real-time payments within your organization?

How can your business determine the most viable use cases for real-time payments and the potential cannibalization of existing products and services?

What considerations are relevant when looking at real-time payments providers?

What is the best way to keep your organization up to date regarding changes in the real-time payments marketplace?

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For a financial institution, integration to an RTP platform is an exercise that needs concerted planning. Moving from a current environment of batch-based processing to a solution that never stops, never has a true "end of day," and that operates every day of the week, every day of the year, with no time between clearing and settling is a monumental shift. Doing so will require changes to nearly every internal banking system. Consider the activities it took one organization to incorporate same day ACH to its operations. JP Morgan shared information at an industry conference regarding the preparation required within its organization to offer same day ACH, a solution not nearly a complex or as evolutionary as real-time payments.[ii]

- 25,000 to 50,000 hours of effort expended over 18 months
- 30 internal departments involved
- 150 systems modules impacted
- 20 client tests, 700 test cases, and 600,000 files tested
- Client communications to thousands
- Internal sales and service training
- Development of new client user guides
- Development of new policy , procedure, and legal terms

Fraud losses could also represent a net additional cost for financial institutions. In RTP, funds are irrevocable (a nice feature for fraudsters) and fraud losses are the expense of the sending FI. So the FI that is initiating a transaction needs to have very good authentication tools and authorization capabilities, because once the real-time transaction is released, it's gone. This point hit home in 2015 and 2016 when a cyberattack found vulnerabilities in banks' fraud detection and the cybercriminals were able to steal legitimate credentials to the SWIFT system that allowed them to take off with over $80 million.[iii]

RTP requires significant, yet unknown investment to build, integrate, and adopt, but the opportunity to generate income from RTP is not well defined. In the following text (and in Table 1 on the various use cases), Mercator Advisory Group identifies the primary participants by category and explores the probability of participants in each category finding a solid business case.

The Builders

The large tech companies are spending millions to build a RTP platform for the U.S. There will be multiple solutions built, but the current preeminent solution, created by The Clearing House and VocaLink, is launching this year. The Clearing House (TCH) is owned by a consortium of 25 large U.S. banks; VocaLink will soon be owned by Mastercard. These builders of the solution are likely to find a business case by charging fees to all the participants who wish to connect to their platform. Like a payment network or processor, they are likely to charge a variety of fees for the gateway services they deliver. They will always make money, but the extent and longevity of their success will be based upon the core processors, financial institutions, and other businesses finding a reason to offer RTP.

The Payment Processors

Those entities in the marketplace that provide processing and related services to financial institutions will offer the means for the institutions that are their clients to integrate to the RTP platform of choice. ACI, FIS, Fiserv, JackHenry, and others are creating their integration tools, products, and support.

Most FIs will need the help of payment processors to execute the integration and to manage the changes required in all downstream processes and all connected systems. The processors will also develop some of the supporting technology for specific applications. As an example, a processor today may offer its FI customers a payment solution.

The processor can develop the technology, the operational tools, and the user interfaces for FIs to have RTP as a part of their bill payment solution. Selling the integration and application tools for RTP capabilities is how processors will find their business case in the evolution to real-time payments. They will make money as long as FIs believe there is a business model for real-time payments. The payment processors' level of success will be dependent on FIs finding profitable applications.

Fintech and Other Developers

Financial technology (fintech) companies, entrepreneurs, and niche players will play their role of creating applications for markets that are not prioritized by the payment processors, financial institutions, and other established players. As the industry has witnessed in other aspects of payments and banking, inventions will run the gamut from fraud mitigation solutions to customer-facing applications that they will resell or sell directly. In this role, fintechs with good products will find revenue streams for their products and potentially buyers for their organizations.

Financial Institutions

The path to a business case is less clear for financial institutions. They will need to buy or build their integration to the RTP platform(s) and buy or build the right products and user interfaces that are meaningful to their customers. Finding a way to monetize the solution with their customers that is in line with expenses is not an easy task. Consider that most retail banks' first foray into real-time payments is consumer person-to-person (P2P) payments, which doesn't generate revenue.

Where the benefit to the sender and recipient is simply the speed of the transaction, the use case will often be limited to exception scenarios. Where fees are applied to transactions, say a consumer's emergency bill payment, the consumer will only pay a fee if the alternative is more punitive (i.e., the person will be penalized or lose a service if the payment is late). Another hurdle for RTP is the presence of other payment types already available that are fast enough. For businesses, if speed is needed, same day ACH and wire transfer services are easy to access. Receiving funds within the day or the next business day may be fast enough for many scenarios, depending on the rate environment or the opportunity cost that a delay of a few hours may create.

As financial institutions look for meaningful business cases, it is essential to the financial equation to consider the product cannibalization that is inevitable where RTP offers differentiating services. Real-time payments will cannibalize some of the domestic wire transfer business, which generates high-margin revenues for most financial institutions. Real-time payments are faster than wires while still offering the critical guarantee of finality of payment, and yet they are expected to be priced much lower than wire transfers.

Wire transfers won't be eradicated. Wires do have some characteristics that RTP does not, including that businesses have fashioned their internal systems to accept, recognize, and reconcile wires. The cost to reconfigure internal systems is significant. Also, wires can be both credit and debit whereas RTP is strictly a credit solution. Financial institutions will be in the position of having to maintain both options to keep their customers happy.

The greatest opportunities are with scenarios that require speed but in which there are also compelling reasons to adopt some of the other features of RTP, including 24X7X365 operations, improved data that can speed up the timeliness and accuracy of reconcilement, and cost savings, not necessarily on the payment transaction fee itself, but on downstream processes. To illustrate this, we consider next the use cases in which RTP is anticipated to make a difference.

RTP Use Cases

The following table lists the payment transaction uses that are often cited as the most probable to be offered early in the rollout of real-time payments in the United States.

Table 1: Anticipated Real-Time Payments Use Cases

Counterparties	Use Case Examples	Benefits Beyond Transaction Speed
Business to Business (B2B)	• Accounts payable / accounts receivable payments	• Faster payment allows for faster acquisition of good and services. • Improved cash flow for the recipient business may decrease need to rely on lines of credit or other funding sources. • May achieve better payment terms from vendors. • Transactions accompanied by more data can improve timing and accuracy of reconcilement.
Business to Consumer (B2C)	• Insurance payouts • Reimburse credits and refunds • Distribute loan proceeds to effect a purchase	• Improved resolution of customer expectations • Quicker possession of goods for the consumer
Government to Consumer (G2C)	• Distribute benefits and aid to individuals	• Improved outcome for individuals in need or in a crisis
Consumer to Business (C2B)	• Pay a debt obligation or make a bill payment	• Avoidance of late fees or other penalties • Business achieves improved cash flow and collection rates.
Consumer to Government (C2G)	• Pay taxes, fees, and other payments owed to government	• Avoidance of late fees or other penalties • Government entity achieves improved collection rates.
Person to Person (P2P)	• Reimburse individuals for borrowed funds • Extend small loans • Send a gift	• Improved consumer experience and more efficient than cash or checks

Source: Mercator Advisory Group

Conclusions: Building for the Future

Use case benefits described above are attractive, but in consideration of the expense of building, integrating, and commercializing a completely new payments rail, the business case is elusive and not proven. In these scenarios, financial institutions providing the real-time payments, or RTP, transaction will have an opportunity to generate fees for faster transactions. Businesses in turn may be able to charge the recipient a fee for receipt of funds delivered more quickly or charge a fee for a transaction to pay an obligation in a timely manner to meet a deadline where a penalty may be looming. Features including not just speed but also the ability to transact over weekends and holidays, after hours, incorporate more information, and someday transact globally, will result in more frequent and consistent use of RTP, not just for exception items. These features are more valuable to businesses than consumers, suggesting the financial opportunity of real-time payments will generated by corporate entities.

The purpose of a RTP solution is less about the near-term financial benefits than about the recognized need to replace some of the aging payments rails that operate today, which given their age will cost more to maintain over time and become more difficult to secure and hard to work with to incorporate new advanced interfaces. There is also a need to remain competitive on a global playing field.

Discussions are underway to create the rules and a governing body to regulate the various real-time payments platforms across the globe. When this is established, the U.S. does not want to be left behind. Not only would that have a negative impact on the ability of U.S. commercial interests, but given the current U.S. position as the largest single economy, not being able to conduct business at the speed of other nations could have a destabilizing impact on the global economy and currencies.

In the end, real-time payments it is not about a near-term business case. It’s about protecting the payments infrastructure for the future.

Endnotes

i. Federal Reserve Bank of Boston. *Costs and Benefits of Building Faster Payment Systems: The U.K. Experience and Implications for the United States.* February 2015.

ii. Analyzing the Impact of Same-Day ACH. Steve Bernstein, March 2017.

iii. Hackers’ $81 Million Sneak Attack on World Banking, *New York Times*, April 30, 2016. https://www.nytimes.com/2016/05/01/business/dealbook/hackers-81-million-sneak-attack-on-world-banking.html?_r=0

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