Alacriti

Consumers Demand Faster Payments:

The Case for Real Time Payments for Financial Institutions

Our world continues to move toward 24/7/365 availability, and consumer expectations for instant gratification are being driven by retail and tech trailblazers like Amazon, Apple, Google and Facebook, among others. This need for getting what consumers want, any time they want it, is finally reaching the world of payments.

That demand has led to a proliferation of account-to-account (A2A), person-to-person (P2P), and other direct electronic payment types. The initial limitations of older infrastructures, as well as the demand and proliferation of these services, has slowly led to payments infrastructure overhaul and modernization efforts around the world. The launch of RTP by The Clearing House in 2017—the first new central clearing and settlement network to hit the market in four decades—set the U.S. on its course toward real-time payments and away (in baby steps) from the legacy wire and ACH networks in use in this country since the early 1970s.

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Around the world, real-time payment initiatives have been ongoing for over two decades, first by South Korea, whose system was launched in 2001, followed by other economies, including India, China (both 2010) and the U.K. (2008), which just kicked off its 2.0 upgrade project. The total number of countries with real-time payment capabilities, or projects to introduce real time capabilities, is over 50—and the stakes are high. Globally, payment revenues will top $2.5 trillion by 2028.[1]

[1] Boston Consulting Group, "Global Payments 2019 Tapping into Pockets of Growth," Oct. 2019

The U.S has been slower to respond to payments modernization, mainly due to the unique complexities of this market, including its size and the number of financial institution players with differing operating models and varied technology platforms.[2] Another factor driving quicker adoption abroad includes the call for modernization being pushed by government regulation, like PSD2 and UK Open Banking. In the U.S., rather than being forced through regulation, the drive for innovation is being driven primarily by competitive pressures from traditional and non-traditional financial services providers.

But it is clear neither the U.S. payments infrastructure nor financial institutions can afford to delay the rollout of real-time capabilities. Technology advances, private businesses and central bank adoption, among other drivers, are pushing real-time payment adoption forward—not the least of which is consumer demand for instant/faster payments.[3]

The bottom line is financial institutions are only in the beginning stages of understanding real-time payments themselves – understanding the opportunities and the risks – but the time is now to embrace real-time payments and be thinking of strategies for implementing the technology and leveraging it for competitive advantage.

The Customer Experience: Why Financial Institutions Need to Embrace Real-Time Payments Now

While initially slower to respond, financial institution adoption of real-time payments is mainly being driven forward by leading businesses seeking faster ways to get paid. It is becoming increasingly clear, however, that it will be essential for financial institutions to embrace real-time payments sooner rather than later for innovation, while some of the potential, value-added benefits are still being flushed out. Still, other early opportunities for financial institutions to improve the consumer experience and potentially create new revenue streams are emerging from areas like bill pay, supply chain and invoice financing, with organizations like the U.S. Faster Payments Council taking the lead identifying industry-wide use cases.

INNOVATION AND COMPETITIVE ADVANTAGE

In this age of increased competition from traditional and non-traditional financial services providers as well as increased commoditization of banking products and services, innovation leading to improved customer experience may be a last bastion of competitive differentiation for financial institutions.

The current electronic infrastructure on which payments is built simply isn't fast enough in many cases. In the absence of real-time payments, what appears to consumers as "real-time" is really just a patchwork system of provisional debits and credits and batch processing.

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[2] Accenture, "Getting Real About Real-Time Payments In The United States," Sept. 13, 2019
[3] Ibid.

INNOVATION AND COMPETITIVE ADVANTAGE *(CONTINUED)*

Bill pay, for example, with its multi-day turnaround and/or lag in receiving credit for payment from billers, is a woefully outdated process that is not living up to consumer expectations for 21st century speed and convenience. The ability for consumers to pay bills and receive payment credit immediately can help them avoid late payments and fees — a convenience they may be willing to pay a premium for, creating a new revenue opportunity. Consumers have also indicated interest in paying for the privilege of receiving money like rebates, refunds and credits from businesses. According to a survey by MetaBank, one in four consumers would be willing to pay a small fee to receive such payments in a matter of minutes.[4]

In terms of P2P and A2A payments, the ability to more seamlessly link payor and payee, or to and from, accounts by eliminating the need for parties to enter provider-specific account setup means it will be much easier and more enticing for consumers to use these services while also increasing relationship "stickiness."

Creating a perception of technological innovation in the marketplace can be a selling point for attracting additional market share in itself. Businesses, for example, have been leading the demand for real-time payment rails in the U.S., so financial institutions serving corporate banking clients can use real-time payment capabilities to attract and retain this profitable segment through enhanced treasury services offerings — while opening avenues to new streams of revenue, potentially including new solutions in areas like working capital management based on the removal of float in the ecosystem.

Finally, innovation through the use of application programming interfaces (APIs) and partnerships with financial technology providers using the new real-time payments infrastructure will expand capabilities previously thought impossible. Financial institution developers will have an unparalleled ability to easily embed payment or money movement services into existing products or services, making payments a tool to build on rather than a hurdle to overcome.

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TRANSPARENCY

Greater transparency afforded by real-time payments can help improve operational efficiency. In the current world of money movement where a bill is paid or money is transferred from person to person or account to account, once the "send" button is pressed, the electronic 1's and 0's disappear into the ether until they land on the other side of the transaction. This lack of visibility not only creates discomfort for consumers, driving calls into sending and receiving institutions, it also places financial institutions in the uncomfortable position of not being able to explain exactly where the consumer's payment is either until it is received by the next destination in the system.

Another benefit of transparency is greater visibility into the line of fees. Greater transparency into how many hands are taking a piece of the pie will bring greater pricing pressure and the ability for financial institutions to offer less expensive money movement options than are available within the current payments infrastructure — another potential arrow in the competitive quiver.

While no one is predicting the death of either wire or ACH in the immediate future, the addition of real-time payment capabilities will provide additional price and convenience levers for financial institutions to pull to meet consumer expectations for a wider variety of options for speed and cost of delivery.

[4] Payments Journal, "An Opportunity for Growth: Faster Payments and B2C Transactions," Aug. 27, 2019

Challenges to Adoption

The adoption of real-time payments will not come without challenges, however. Addressing these ahead of time, there is no reason financial institutions can't ensure a smooth rollout of real-time payments that delivers on consumer expectations for speed and accuracy, as well as opens new lines of revenue and competitive advantages for the institution.

TECHNOLOGY INVESTMENT

The truth of the matter is many financial institutions still rely on mainframe computers and legacy systems designed for batch processing to manage their operations. While the computing power is there, integration to newer systems is patchwork at best, non-existent at worst. According to research by IBM, as late as 2014, 92 of the top 100 banks were still using mainframe computing.[5] "Moving from a batch structure to a real-time transfer system requires a complete transformation of the banking industry's IT structure," according to Forbes.[6]

The race to implement real-time payments—and reap its competitive potential—is already on, however. Financial institutions should begin to assess and budget for needed technology upgrades while considering how to offset investments through hard and soft competitive advantages to increase revenue, strengthen customer loyalty and gain additional market share.

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EDUCATION

As with the rollout of any new technology, educating staff, customers and prospects is key to a successful rollout.

For example, when companies were asked why they would not be interested in real-time payments, over 50 percent indicated they didn't know enough about it.[7] Education and a strategic communications plan will be essential to ensuring consumer interest in and adoption of real-time payments services.

Top educational considerations will focus on the features, benefits and risks of real-time payments. A multi-channel strategy for outlining the differences in terms of speed, pricing and risks associated with real-time payments versus legacy transaction types and networks being used by the financial institution will be essential to successful adoption by consumers.

Also, educating staff, customers and the marketplace on the value proposition of real-time payments services for cross-sell/up-sell purposes, as well as a way to attract additional market share through offering cutting-edge innovation will help ensure program profitability.

NO ROOM FOR ERROR

One major point that will require very clear communication to both staff and consumers is the immediacy and permanence of real-time payments, in particular the operating rules from The Clearing House for the RTP system. Consumers moving money over RTP rails will need to understand that once a payment is sent, it is gone from their account and immediately available to the recipient, making the payment irrevocable.

Operational procedures for ensuring consumers are 100 percent sure about the accuracy of payment information, as well as alleviating liability for the financial institution by ensuring consumers have been informed about the risks of using RTP services, should be implemented.

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[5] Forbes, "FedNow: Are US Banks Ready For Real-Time Payments?," Jan. 6, 2020

[6] Ibid.

[7] PYMTS.COM & Mastercard, "The Real-Time Payments Innovation Playbook"

SAFETY AND SECURITY

While real-time payments itself can help reduce fraud and mitigate risk by eliminating the steps and stops the payment makes in its journey, thereby reducing the time between payment initiation and receipt, there will be new considerations for financial institutions when implementing real-time payments technology and services.

Account takeover (ATO) is one method fraudsters use to deplete funds using real-time payments rails. In an ATO scenario, the fraudster gains account credentials and uses them to drain the account of funds — often before the legitimate account owner becomes aware that money has been withdrawn.

Of course, there will also always be cases where cybercriminals extort account credentials from unwitting victims, as well as convincing victims to send money under false pretenses. While these are not new types of bank account fraud, the instantaneous nature of real-time payments makes detection and prevention more challenging.

As real-time payments is becoming more ubiquitous, however, firms are already responding with solutions as well as ways financial institutions can mitigate risk.

Mercator lists some potential ways financial institutions can thwart real-time payments fraud, including:

- Multifactor authentication (MFA) between devices and channels
- Use of one-time tokens
- Real-time validation of account details
- Standardized APIs across all financial institutions
- Implementation of biometric authentication

Mercator foresees the focus of fraud mitigation efforts on verifying the account and user's identity as opposed to emphasizing the transaction.[8]

REASSESSING BANKERS' HOURS

Perhaps the greatest paradigm shift financial institutions will experience is the one from a nine-to-five, Monday to Friday mentality, to a 24/7/365 model. The onset and rapid adoption of self-service digital banking has already set consumer expectations for anytime, anywhere access, but some services—wire transfers, for example — must be conducted during "banking hours," or else be scheduled for next business day execution. Such points of friction in the consumer journey promote disintermediation to non-traditional channels.

"Bankers' hours" also affect same-day ACH payments — the current "faster" payments methodology available to most banking consumers outside of real-time payments. ACH transfers initiated after the final cutoff window for the day are delayed until the next business day, adding more time and potential points of friction around customer experience and potential for fraud.

[8] Mercator Advisory Group, "Faster and Real-Time Payments Fraud," Jan. 21, 2020

Faster, Better, Stronger

Businesses are driving it and consumers expect it — and they're willing to pay. The demand for real-time payments is putting pressure on financial institutions to implement it.

With the Fed's announcement of its own real-time payments network, FedNow, to be launched as early as 2023, adding a new competitive element between the Fed and the bank-owned RTP network from The Clearing House, innovation is sure to evolve rapidly, giving financial institutions plenty of options for implementing an attractive service.

While the real revenue potential of services built around real-time payments is still to be determined, it's obvious that the potential to broaden product offerings that include different elements of cost and speed based on consumer needs and preferences for a commensurate price is there.

One thing is certain, though — financial institutions can no longer delay building a real-time payments strategy into their plans. In a world of shrinking margins, product commoditization and increased competition, services built around real-time payments to improve the consumer experience and open new revenue streams will be essential to not only survive, but thrive, well into the future.

About Alacriti

Alacriti is a leading financial technology company dedicated to helping our clients accelerate their digital transformation. Alacriti's cloud-based platform, Orbipay, delivers solutions in the areas of electronic bill presentment and payments and digital disbursements, empowering our clients to provide innovative digital payment experiences today's consumers demand. In addition to driving modern and frictionless digital payment experiences, our clients benefit from faster time to market and continuous innovation on a proven platform.

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