MARKET INSIGHTS

ACCELERATING PAYMENTS IN THE U.S.
The March toward Real-time Payments

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Faster, smarter, better: This is the future of payments. Processing timelines have been shortening for decades, to the point where faster payments are cleared and settled in seconds. More importantly, we are now on the cusp of an era of smarter payments that include additional data in order to better support commercial and retail use cases, such as remittance information. Markets around the world have been rolling out real-time payment systems over the last decade, with differing settlement times and remittance data schemes. Great strides in efficiency have been made through the provision of expanded data elements, supporting additional use cases and simply faster clearing. Prompted by the Federal Reserve, the U.S. banking system is coordinating more closely to accelerate the speed and efficiency of payment systems in the U.S. and to align with global remittance data standards.

In 2013, the U.S. Federal Reserve concluded that the banking industry should create a faster scheme to modernize U.S. payment systems within 10 years. The Fed now leads a diverse 300-person Faster Payments Task Force (Task Force) that is well under way to achieving consensus on the desired characteristics and criteria. In 2016, the Fed will invite the private sector to submit their proposals to implement a faster U.S. payment system for evaluation. I have the honor of representing FIS™ and the nonbank segment as one of 19 elected steering committee members of the Task Force.

The Fed’s initiative is only one of many different faster payment fronts in the U.S. NACHA has approved rules for Same-day ACH, and The Clearing House is starting development of its Faster Payments solution in early 2016 in partnership with Vocalink and FIS. I expect several other initiatives that are currently in the planning and investment stages to announce solutions in 2016. As members of The Clearing House, large U.S. banks will heavily influence the pace of faster payments adoption in the U.S. compared with other countries. Meanwhile, FIS is aligning to support all depository institutions in the diverse U.S. market – large, regional, community and credit unions – to efficiently enable immediate clearing in line with global remittance data standards (faster, smarter, better).

Payment Envy
Current payment systems do not work in the way most consumers and businesses expect in a digital, mobile, real-time world. Consumers expect digital money to act more like physical cash than checks. As businesses become more global, they are increasingly aware of visibility, liquidity and foreign exchange exposures. Globalization, digitalization, mobilization and competition continue to accelerate, creating a need for cross-border payments that are fast, efficient and accessible globally.

Currently, about 16 countries have already implemented fully operational immediate payments solutions.¹ Many other countries are at various stages of evaluation or implementation, most notably the U.S., with the prospect of pan-European instant payments following close behind. Each implementation operates according to a unique set of parameters, guidelines and limits, but all consistently deliver virtual instant payment reconciliation.

Show Me the Money
What is not to like about immediate payments? The answer is unsurprisingly simple: a challenging business model, where an ambiguous payment fee structure exacerbates uncertain return on investment. The Fed has been mindful of the financial constraints facing many banks, especially community banks, and also recognizes the revenue concerns being lobbied.

While the Fed defines how the solution could operate, of paramount importance to banks is identifying viable and profitable business cases. Wisely, the Fed is looking beyond the retail consumer market for immediate payments to business applications. While personal payments (P2P) remain within the remit, the business angles (B2B and B2P) are potentially more lucrative. Five faster payments use cases comprising 12 percent of total U.S. payments have been identified, and by the Fed’s own estimate, the business case for a real-time payments system is “net neutral to negative” through 2025.² However, the Fed has agreed that the business case can become positive if expanded to include anticipated additional value-added services.
Five use cases comprising 12 percent of total payments could benefit from faster authorization and clearing, availability and/or settlement

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<th>Use cases</th>
<th>Volume and % of total payments</th>
<th>Speed required</th>
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| B2B\(^1\) ad hoc, low value (e.g., just-in-time supplier payments) | 11.1 billion (5%) | • Real-time authorization/clearing  
• Intraday availability of funds  
• Intraday interbank settlement |
| B2P ad hoc, high value (e.g., insurance claims, legal settlements) | NA | • Real-time authorization/clearing  
• Real-time availability of funds  
• Late-day interbank settlement\(^3\) |
| P2P\(^2\) transfers (e.g., rent repayment to roommates) | 4.3 billion (2%) | • Real-time authorization/clearing  
• Real-time availability of funds  
• Late-day interbank settlement\(^3\) |
| B2P ad hoc, low value (e.g., temporary employee wages) | 3.2 billion (1%) | • Intraday authorization/clearing  
• Intraday availability of funds  
• Late-day interbank settlement |
| P2B ad hoc, remote (e.g., emergency bill pay) | 10.3 billion (4%)\(^3\) | • Real-time authorization/clearing  
• Late-day availability of funds  
• Late-day interbank settlement\(^4\) |

\(^1\) Business includes government.  
\(^2\) Person-to-person commerce is considered a special case of person-to-business transactions. Person includes underbanked and unbanked.  
\(^3\) Includes person-to-business ad hoc remote time delay (e.g., catalogue purchases).  
\(^4\) Industry interviews suggest that, given real time authorization/clearing and/or real time availability of funds, settlement may need to be intraday.  
Source: McKinsey expert and industry interviews, public consultation responses; McKinsey Payments Map; Consumer Financial Life Survey

For a large, complex financial institution, a wholesale modernization of payment infrastructure would cost in the tens and possibly hundreds of millions of dollars. Such a transformation does not happen overnight; it is more often a long-term, multiyear initiative. Consequently, the Fed has called on the industry itself to reach consensus on a timetable for implementation of faster payments that U.S. banks can tolerate.

**Payments in a Flash**

As larger U.S. banks operate global infrastructures, many have been independently moving toward a more real-time infrastructure and could theoretically process immediate payments today. But immediate payment systems involve significantly more than the ability to clear a payment within seconds. It is not just a technology issue; it is also about risk.

- Who is liable if things go wrong in an environment where the effectiveness of fraud prevention and Know Your Customer (KYC) are not guaranteed?
- Where is the system accessible from?
- Which message formats are employed?
- What are the settlement processes and options?
- How is security ensured?
- What are the use cases for consumer, business and corporate customers?
Within the U.S. market, industry participants led by the Fed are in the process of defining how such a solution could operate and are currently evaluating several criteria.

**Evaluation Criteria for Immediate Payment Systems**

- **Ubiquity**
  - Accessible and usable
- **Efficiency**
  - Competitive, cost-effective and scalable
- **Speed**
  - Authorization, clearing and settlement
- **Security**
  - Initiation, authorization, fraud and privacy
- **Governance**
  - Effective, transparent and inclusive
- **Legal**
  - Regulatory framework

Catalyzed by the Fed, the industry Task Force looks set to endorse international standards, such as ISO 20022 (an XML-based flexible message format), over the more traditional and more widely implemented card-based payment standards, such as 8583 (short fixed messages permitting only essential payment information). Such a decision improves business case possibilities because it widens the potential of immediate payments to add significant value to transactions such as billing, invoicing and foreign exchange rates. It also allows for potential use cases where payment capability can be built directly into business software to enable corporations to conduct their banking directly from where they do their business. It would eliminate the need to export transactions for uploading to bank-specific interfaces.

Larger financial institutions may be able to justify the investment needed to launch instant payment solutions, but the business case is challenging for regional and community operations. With smaller in-house IT departments that are not comparable to the behemoths, they rely more heavily on vendor solutions, often through outsourcing. Regional and community banks must ensure their vendors are in step with market developments. At FIS, we have led the way through the provision of payment systems to all tiers of banks, both large and small. Over the years, we have invested in, and will continue to invest in, payment solutions that make it efficient for banks and credit unions of all sizes to access real-time payments as they come on stream.

**The Future of Payments**

Don’t expect the “big bang” implementation of faster payments; many banks are planning a phased rollout globally of consumer and business services built on a backbone of immediate payments:

1. Consumer P2P payment services and retail point-of-sale capability
2. Bill payment for consumer and business markets
3. Fully fledged business payments services integrated into their infrastructure
The hope is that migration toward immediate payments will also open opportunities for offering additional services above and beyond payment processing. Even smaller banks using vendor solutions will be able to participate in additional revenue-generating activities and differentiate themselves by adding tangible value across each transaction.

We will continue to see a plethora of payment options. Wire transfers, ACH transfers and check payments have certain inefficiencies, but they will not be decommissioned anytime soon. Not all payments are created equal; some transactions are better suited to a credit card, some to a wire or ACH transfer, while others demand immediacy. While not a panacea, immediate payments will help us all better align the various payments use cases with the most appropriate payment system.

Stay tuned, as the faster payment juggernaut is certainly coming to the U.S. As we progress through 2016, I will provide periodic updates based on my participation in the Fed Task Force and FIS’ work with The Clearing House to keep you apprised of market developments and the exciting faster payment capabilities that FIS is planning for clients.

Learn More
For additional information on this topic, please contact the author.

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Endnotes

2. This is calculated based only on transaction migration within the five primary use cases identified by the U.S. Federal Reserve during their analysis in January 2015, “Strategies for Improving the U.S. Payment System.”