

NEARING THE FINISH LINE

They've been slow in coming, but faster electronic payments soon will be arriving in the U.S.

The upside lies in the phrase "faster payments," with various proposals calling for real-time settlement, a term that means settlement within seconds. No more waiting a business day or longer to have use of funds. And retailers, billers, and consumers will have more payment choices, depending on their need for timely payment.

Along with increased speed will come more information related to the payment, at least in some systems. High-capacity messaging is one of the big selling points for The Clearing House Payments Co.'s new real-time payments system, perhaps the most talked-about project in the entire faster-payments movement.

The downside could be more fraud, if in their rush payments providers can't screen suspect transactions in time. Then there is the question of revenues. Consumers already have already shown themselves to be highly resistant to payments fees, so providers are hoping to persuade enough businesses to pay for increased speed to generate a return on investment. But will faster-payments systems cannibalize existing revenue streams?

Payments executives say the upside far outweighs the downside. Given demand by businesses and consumers for speedier payments and what's going on in other countries, some say the U.S. has no choice but to work quickly on modernizing its payment system.

"The real thing about faster payments as a whole is it's a necessity," says Travis Dulaney, chief executive of Fort Lauderdale, Fla.-based Push Pay Inc., which goes by the Push Payments brand name and provides technology for so-called push-credit transactions. "Ultimately what we want to do is have a real-time settlement and clearing environment in the future."

'THE HOME STRETCH'

People in payments have been talking about speeding up payments for years ("Faster Payments," June, 2013). The first comprehensive view of the matter took shape around the Federal Reserve's Payment System Improvement project, an effort that sprang from a consultation paper issued in 2013 and took formal shape in 2015. The initiative includes two major task forces, one dealing with faster payments and the other with payment security.



The Fed will soon release its long-awaited report on faster payments. Will it help the U.S. catch up with other countries?

BY JIM DALY

At mid-year, the Fed's Faster Payments Task Force is expected to release the second part of what it calls its final report. The first part came out in January and reviewed the task force's work and objectives. Part Two will unveil what are expected to be 19 finalist proposals that the task force evaluated in detail with the aid of consulting firm McKinsey & Co.

Sean Rodriguez, a senior vice president at the Federal Reserve Bank of Chicago and the Faster Payments strategy leader for Federal Reserve System, says the Fed is now in "the home stretch of all of this interaction. I'm feeling good about all of the work that's been done."

When it pulls back the curtain, the Fed will showcase the proposals as essentially best-practices systems, some of which are already on their way to commercial adoption. The Fed sees its role as a facilitator, not as a "thou-shalt" regulator that tells the payments industry to use this or that service, according to Rodriguez.

"We do not in fact have the authority to mandate anything in this regard in the payments space," he says.

The Fed won't reveal what it calls the "proposers" until the report is out, but some of the 19, including The Clearing House and Des Moines, Iowa-based fintech Dwolla Inc., have gone public on their own. While The

Clearing House is preparing an entirely new payments rail, other proposers are aiming for niche markets or specific needs. Ripple Inc., for example, is proposing a real-time cross-border payment system.

But not all of the recent faster-payments activity is occurring under the Fed's umbrella. After years of bank debate, NACHA, governing body of the automated clearing house network, introduced same-day settlement of ACH credit transactions last September and is planning the same for debit transactions this coming Sept. 15 ("Banks' Upbeat Report on Same-Day ACH," March).

Meanwhile, spurred by strong competition from non-bank payments providers such as PayPal Holdings Inc. with its Venmo person-to-person payments service, banks are getting serious with their own P2P services, including the new Zelle real-time service (box, page 28).

'WE ... CANNOT BE LEFT OUT'

Some 20 countries already have adopted or are about to adopt faster-payments systems of one type or another, beginning with Japan way back in 1973. Half

of those countries' systems, however, date back no farther than 2010 (chart, page 30). These developments clearly provoked worries among American payments executives about being left behind.

"That was an impetus for the Fed to take action," says Roy DeCicco, managing director in the Treasury Services unit of banking giant JPMorgan Chase & Co. and the chairperson of one of the Faster Payments Task Force's work groups. "We don't have the same level of development in the U.S. market."

The demand for faster payments will only grow as currently nascent systems build user bases, according to some observers.

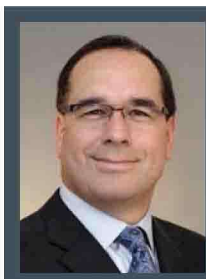
"Based on what has happened in other countries, once consumers and businesses experience the opportunities with real-time payments, they do not go back," says a June 2016 report from Boston-based research firm Aite Group LLC. "Think about how we can no longer live without our phones or the idea that they are also our cameras. Financial institutions need to recognize the benefits of real-time payments and ensure they grab the opportunities before it is too late."

It's not just big banks like Chase that see new opportunities in faster payments. Small ones also see a need to get in on the action.

"We just cannot be left out," says Robert Steen, chairman and chief executive of Bridge Community Bank, a three-branch bank in Mechanicsville, Iowa, with \$90 million in assets. "We have to have a payment solution for our customers that is competitive both in terms of product and service, and pricing." Steen serves on the Fed's 320-member Faster Payments Task Force and its 18-member steering committee.

With its goal of giving financial institutions big and small along with processors, fintechs, retailers, and others a voice in the improvement initiative, the Fed recruited more than 500 people in all for the faster-payment and security task forces. That massive size drew some snickers about bureaucratic over-inclusion, but Rodriguez says "it turned out to be a blessing in disguise. It indicated the enthusiasm in the industry was really high."

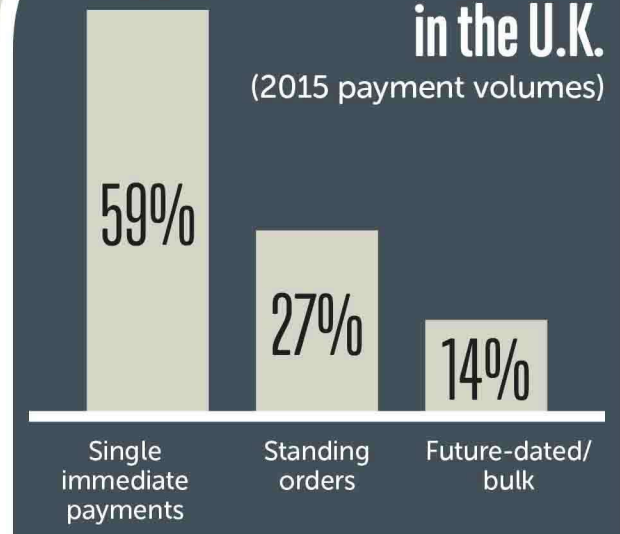
The task force's vision of an improved payment system includes not just fast approvals, clearing and settlement, and visibility of payment status, but also ubiquity,



"It's not easy to get everybody on the same page, but we're taking a heck of a run at it," says the Fed's Rodriguez.

Types of Faster Payments in the U.K.

(2015 payment volumes)



Source: Faster Payments Scheme Ltd., The Clearing House

interoperability among disparate systems, efficiency, security, and a strong legal foundation that protects the rights and privacy of consumers as well as intellectual property.

"That's clearly going to be a tough nut to crack," says Rodriguez, but recommendations for those issues will be in the final report, he adds.

'AN ENTIRELY NEW RAIL'

As the financial industry, merchants, and billers wait to see all of the proposals, New York City-based The Clearing House's Real Time Payments project has garnered considerable interest. Under development since 2014, the system can handle a variety of business and consumer payments. Testing will begin in the second or third quarter with business-to-business payments, says Steve Ledford, senior vice president of product and strategy at the bank-owned not-for-profit.

The Clearing House, operator of one of the nation's two ACH switches, originally planned to start testing the system with consumer bill payments, but strong bank interest in B2B payments prompted the change, according to Ledford. "We got so much interest in business-to-business that we thought, 'let's start demonstrating that,'" he says.

The system's technological backbone comes from United Kingdom-based VocaLink Holdings Ltd., operator of the U.K.'s Faster Payments system (chart) as well as Britain's equivalent of the ACH. (Mastercard Inc. has a pending agreement to acquire VocaLink for \$920 million.)

TCH's tech partners also include processor Fidelity National Information Services Inc. (FIS), and the company is certifying other processors to link to its

system, thereby making the service available to thousands of financial institutions.

The TCH system is that rare thing—something new under the sun. It won't rely on the ACH or the card networks' electronic highways connecting businesses and consumer financial accounts.

"This is an entirely new rail," says Ledford. "We felt it was necessary to build a new payments [system] that was inherently real time ... rather than try to build those on top of the existing payment networks."

So just how fast is this new rail? Ledford envisages most transactions settling in five seconds or less.

"The maximum allowed is 15 seconds, but we believe it will be a couple of seconds," says Ledford. "In our payment system, settlement happens immediately. There is no gap between the clearing of the payment and the settlement of the payment."

Transactions will be of the credit type, meaning they are initiated by the payor as opposed to, for example, a biller debiting a customer's checking account. As such,

COULD THE FLEDGLING ZELLE OUTFRONT PAYPAL'S VENMO?

Competition in the person-to-person payments arena is about to get a lot more interesting with the impending launch of the bank-controlled Zelle, a service many observers believe could give PayPal Holdings Inc.'s Venmo a run for its money.

Venmo's mostly mobile service, which has captured the imagination of a younger crowd with its blend of swift payments and social media, posted \$5.6 billion in volume in the last quarter of 2016, a 126% year-over-year growth rate. As recently as 2014's fourth quarter, the service had not yet reached the \$1 billion mark in quarterly volume.

But while that kind of growth has all eyes riveted on Venmo, an older, less celebrated P2P product is actually far bigger and racking up respectable growth of its own. JPMorgan Chase & Co. disclosed in an early March investor day presentation that its QuickPay app processed \$28 billion last year, up 38% over 2015, on 94 million transactions.

While Venmo is growing faster, its dollar volume in 2016 came to \$17.6 billion, less than two-thirds of QuickPay's total. Chase also revealed that 4 million households are using QuickPay, a 30% increase in one year.

Those are impressive results on their own, but there could be bigger implications very soon. Chase and six other owner banks this spring are expected to launch Zelle, a P2P payments network that will link a total of 19 U.S. financial institutions with 75 million mobile-banking accounts. A substantial reworking and rebranding of an earlier bank-developed P2P network called clearXchange, Zelle will launch with a multimedia marketing campaign including digital and broadcast components.

Another Zelle owner, Bank of America Corp., has already enabled the service with an update to that banking giant's mobile app in February. Zelle executives clearly expect the other Zelle members to follow suit with their apps as they seek to use mobile to deepen customers' engagement with their products and services.

"You're going to start to see the Zelle brand in all the banks' experiences," says Melissa Lowry, vice president of marketing and branding at Early Warning Services LLC. The bank-owned Early Warning, a Scottsdale, Ariz.-based risk-mitigation firm, is Zelle's parent company.

Besides accessing Zelle through banks' mobile apps, consumers also will be able to download a stand-alone Zelle app for Apple and Android smart phones. Whether through the individual bank apps or the stand-alone app, users will "have the same experience" and be able to "do the same things, with the same features and functionality," says Lowry.

For users sending money to a recipient with a demand-deposit account at a Zelle member, the system will enable settlement to occur "within minutes, typically even faster than that," says Lowry.

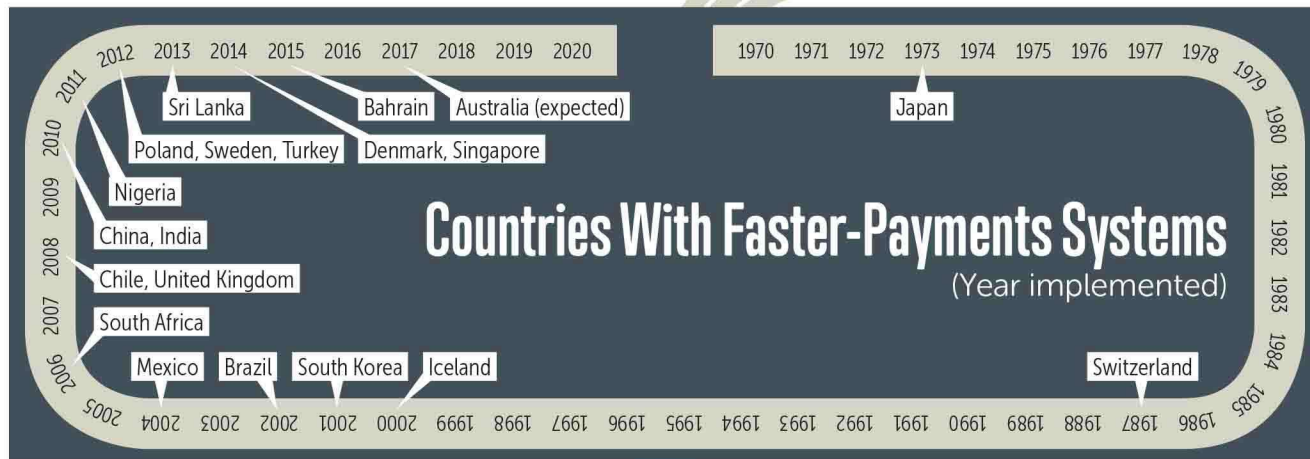
In addition to the direct bank participants, Zelle has struck partnerships with processors Fiserv Inc., Jack Henry & Associates Inc., Fidelity National Information Services Inc. (FIS), and Co-Op Financial Services to give community banks and credit unions access to its service. And through agreements with Visa Inc. and Mastercard Inc., Early Warning will leverage the Visa Direct and Mastercard Send real-time platforms so that U.S. debit card holders can send and receive money through Zelle.

A Chase spokesperson did not return a call from *Digital Transactions* seeking comment on whether, or when, the bank might include QuickPay in the Zelle service. But the inclusion of QuickPay's users, in combination with the P2P customers of the other financial institutions, could give Zelle a significant boost—and also allow the fledgling service to outrun Venmo, at least for a while.

As of mid-March, it was not clear if Zelle's marketing campaign would take direct shots at Venmo.

"One of the things we're really focused on is being a viable alternative to cash and checks," says Lowry. "There's a huge opportunity there."

—John Stewart and Jim Daly



Source: "The U.S. Path to Faster Payments, Final Report Part One," Federal Reserve

there will be no reversals. The system will have a process so that an originator can get funds returned in rare cases, a process that involves a separate transaction. But Ledford says TCH has built in procedures to "drastically reduce the number of errors" that generate disputes.

A key part of TCH's system is its messaging capability, which is built in accordance with the ISO 20022 standard. Without getting technical, suffice to say that the standard, which Visa Inc. uses and is used in Europe and some other parts of the world, facilitates the transmission of large amounts of data related to a payment, along with the payment.

"We expect there will be more non-payment messages than payment messages," says Ledford. "[ISO 20022] really has emerged as the global standard for any new payment system."

As part of the messaging, "every payment will have instant confirmation," says Benjamin Isaacson, executive director in Treasury Services at JPMorgan Chase. He calls that feature "very advantageous in a business-to-business environment. Real-time payments will work across a variety of scenarios."

If only one proposal comes out of the Fed process that everyone wants to use, "The Clearing House hopes to be that system," says former banker Linda Coven, a senior analyst at Aite. "They have certainly spent the most time, money, and resources building this new set of rails. They feel they have the right answer."



"In our payment system, settlement happens immediately," says The Clearing House's Ledford.

WHEN FASTER IS TOO FAST

Yet, as technology makes faster payments a real possibility, the payments industry is grappling with new issues related to speed, security, and revenues. One such is whether a real-time payment is justified if the security apparatus can't keep up.

"There's an argument for intentionally not being as fast as the technology allows," says George Warfel, general manager of fintech and payments strategy at consulting firm Haddon Hill Group, Oakland, Calif., and author of *Digital Transactions*' "Payments 3.0" column (page 16). "The reason is when there is risk that can't be resolved instantaneously," says Warfel, also a member of the interoperability sub-workgroup on the Faster Payments Task Force.

Networks, operators, and banks insist they're up to the job. In its first quarter of implementation, same-day ACH did not generate any increase in fraud, according to Janet O. Estep, president and chief executive of Herndon, Va.-based NACHA. Estep got that information from a NACHA poll of financial institutions generating two-thirds of the originating volume.

"One-hundred percent had seen no increase in fraud," says Estep.

Besides risk control, faster payments create business issues about when to use them, and about pricing and profits. Observers note that the appearance of real-time systems will not increase the overall number of payments.

"In the end ... all systems are a little bit of a competitor with each other," says Estep. "There's some amount of substitution that flows from one to the other."

Financial institutions are trying to figure out just when to take advantage of real-time options versus using other systems such as the ACH. The need for speed will determine whether a payment should be made in real-time rather than waiting a few hours under the ACH network's three daily settlement windows.

“We think use cases in which speed is critical, any kind of emergency payment, we see an opportunity for that,” says JPMorgan Chase’s Isaacson.

Despite the arrival of real-time systems, Estep believes the ACH network will continue to grow. “I would hope as an industry we would continue to capitalize on the strengths of each system,” she says. “Certainly having real-time payments as an option can be helpful.”

Same-day ACH gives financial institutions options for quicker, if not necessarily real-time, settlement, according to Estep. So far, about half the same-day volume is business-to-consumer payments, including payroll, pension, and various non-recurring transactions such as payments by insurance companies to consumers, with another third being business-to-business payments. “Same-day ACH is ubiquitous, it’s here,” she says.

REVENUE QUESTIONS

Besides usage, an even bigger unknown with faster payments is revenues—who will pay to use them, and will they be profitable for providers? Banks and credit unions will set pricing to end users, and it seems likely

businesses rather than consumers will be the ones paying the freight, at least at first.

“When we’re looking at revenue, we’re looking at areas where we can add value,” says a banker who asked not to be identified. “Urgent payments and information-rich payments are areas businesses are willing to pay for.”

In the P2P space, San Jose, Calif.-based PayPal, in an effort to capitalize on Venmo’s wild popularity and to make some money on the free service, has introduced a service called Pay With Venmo that will let users pay merchants for goods and services and will allow PayPal to collect acceptance fees.

With testing and many issues still to be sorted out, Aite Group’s Coven predicts “we’re still talking two or three years out before we see some real significant movement” in commercialization and usage of new faster-payment systems.

Over at the Fed, Rodriguez says his groups are “trying to put all that craziness together” as the faster-payments project nears its culmination. “It’s not easy to get everybody on the same page, but we’re taking a heck of a run at it.” **DT**