

Real-Time Payments: How to Monetize and Stay Competitive

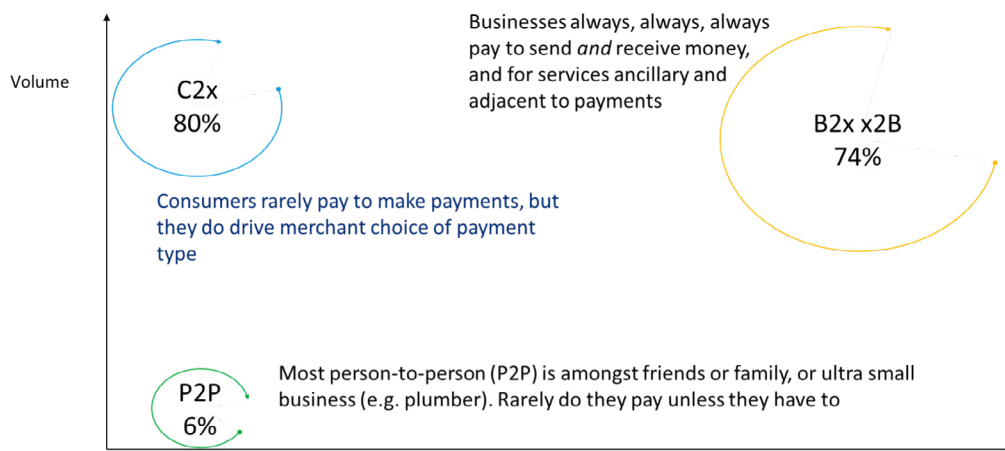


Instant or real-time payments are gaining traction in the U.S. How can financial institutions capitalize on this opportunity? It's time to plan the best way to create revenue and the best user experience possible. However, as financial institutions move forward, there are a few elements to consider. In a Bank Automation News hosted [webinar](#), Gareth Lodge, Senior Analyst, Global Payments at Celent, and Mark Majeske, Senior Vice President, Faster Payments at Alacriti, discussed how financial institutions can both optimize and monetize instant payments.

Real-Time Payments in the U.S.

Lodge began the discussion with an update on where real-time payments are in the U.S. right now. "I think we're starting to see signs of growth, and certainly, we're starting to see more momentum, but it's interesting to know how many countries have adopted real-time payments and how far and fast they have gone. In 2021, there were nearly 120 billion real-time transactions around the world (some markets are growing by tens of billions of transactions a year). The U.S. is frankly a long way behind the rest of the world in terms of its real-time adoption. There are 49 years and 50 countries to learn from."

Lodge shared that many banks across the U.S. perceive real-time payments as a P2P product. While it has a good role to play in that space, when the total volume of payments in most markets is broken down, Celent finds that only 6% of transactions are really P2P. It's unlikely that the U.S. will be much different. That 6% is generally among friends and family or very small businesses. This audience doesn't want to have to pay for payments, so they choose what is cheapest and easiest. Eighty percent of the transactions start with consumers, and they drive adoption because businesses want to provide what's in demand. Also, consumers who are familiar with real-time payments will wonder why they can have instant payments as a consumer but not as a business. B2X or X2B comprises 74% of transactions—and businesses will pay to send and receive money. So rather than focus on the 6% who will be reluctant to pay, it makes sense to focus on the 74% who know they have to pay and value those payments because they are in commerce.



Source: Celent September 2022

1% Rule of Payments

Lodge explained the 1% Rule of Payments. “The 1% rule of payments boils down to following the money or your clients will. This comes from the observation of the internet. Of 100% of content, 10% of people interact with it; but it's only 1% of the market that actually generates the content in the first place. Similarly, in the payments market, less than 1% of banks generate or are receiving those payments. For example, the NACHA Top 50, which is 0.5% of the total number of banks, in 2020 accounted for 86% of all originated volumes and 61% of received volumes. You might want to eventually send something to everybody, but it's a very long tail in the U.S. for banks. Focusing where needed is the first part of the equation. If you look at the Zelle transactions and how they're skyrocketing (it will be well over 2 billion transactions this year), it tells you that it's meeting a need. If you can address that need and build a great experience, it may well generate more acquisition of customers, but it will certainly stop churn of customers as well, whether it be to a fintech or another financial institution.”

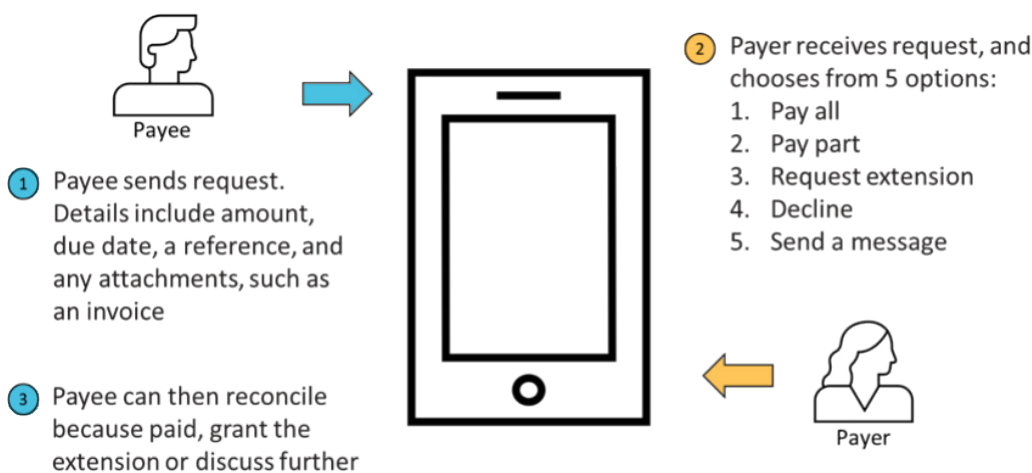
Real-time payments are a significant change. If a bank gives the impression that real-time payments are just faster ACH, it misses a lot of opportunities. “I would say categorically that leading banks in pretty much every market with a good real-time payment volume have hundreds, if not thousands of use cases. They’ve thought very carefully about why a client should use them, the benefits, and how it differs from other existing payment types,” Lodge shared.

Building Blocks of Real-Time Payments Use Cases

There are five key building blocks of use cases for real-time payments.

- 1. Speed** – A real-time experience is key, and there is no lag in the user’s experience. Real-time payments can replace other payment methods at the point of sale.
- 2. 24/7** – As we move into a world where everything is 24/7, customers also expect everything to be 24/7 for payments.
- 3. A Single Message** – Many good use cases involve being able to embed a transaction in a value chain and use business rules or automation to trigger the next steps, which comes from it being a single message vs. batch.
- 4. Irrevocable, Good Funds** – Once the funds are in the account, there is no worrying about a check bouncing, a transaction recalled, etc. That’s good for use cases around working capital but also where you’re eliminating fraud. Before handing over goods, sellers can have the funds before giving possession of that item.
- 5. Enriched Data** – This is the capacity to provide more complete remittance information with payments. This is important for both automation and reconciliation. Not only does the transaction include who it’s from and who it’s for, but also *what* it’s for.

Banks that do well in real-time payments embed themselves in the client’s process. Real-time payments are a tool to deliver payment solutions, which fall into two categories: overlay services and digital tools. Overlays are value-added solutions available to all that include QR codes, Request for Payments (RfP) alias directories, etc., that solve problems. The example below is a UK Request for Payment solution.



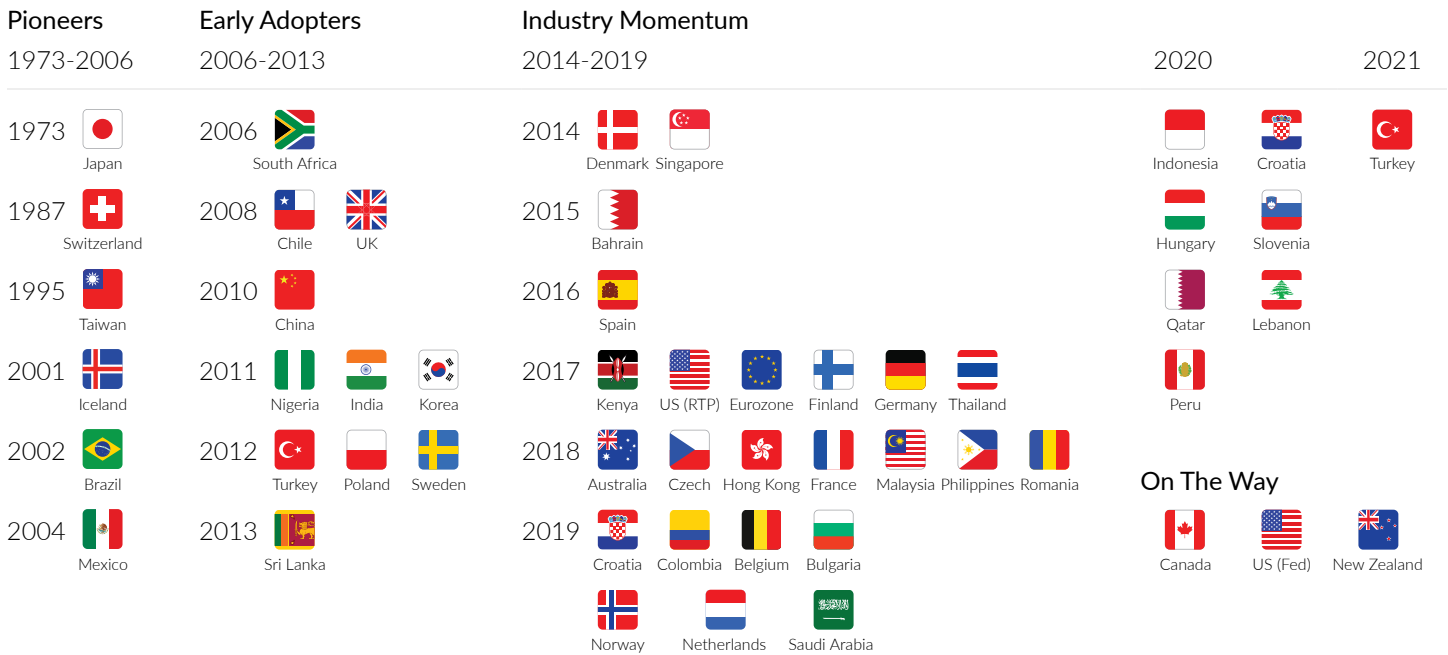
Source: Celent September 2022

Digital tools are about how the real-time payment is used. Leading banks expose APIs to make it possible for clients to embed real-time payments in their workflows. This moves the real-time payment away from a payment product into a payment solution. Not only does it make the bank more sticky, but it's an opportunity to generate revenue. Examples include instant loan disbursement, "pay me now," and conditional payments (e.g., factory release of goods). For example, in India, a large internet retailer was having a challenge with returns. A courier would collect the returned goods from the consumer and take them back to their depot and then back to another depot that specialized in inspecting goods. If approved, they would send a request to the head office to remit payment. It could take two weeks before the consumer would know whether or not they were going to receive a refund, and often the notice that they were was when the payment hit their account. The bank's solution to this problem was to enable the courier to do the inspection using an API. So when the couriers pressed "yes" on the device to accept the item for refund, it passed the data up the line to automatically trigger a real-time payment to the consumer. The consumer, therefore, knew even before the courier left the premises that they got a refund. Not only was it a better customer experience, but the retailer benefited from cutting costly steps and being able to get the product back out for sale much quicker. Ultimately, it's a solution that would not work without a real-time payment. So it's important to not just view real-time payments as a "faster than ACH option" because it's so much more than that.

Lessons Learned

When looking at transaction revenue, Lodge asserted that the key is to look at the margin. "A lot of people keep telling me how much revenue checks make, but they are less confident about what the margin is. So first, manage to the margin. The second piece is to be able to charge more for a solution. The third is that a real-time payment is only as real-time as who can reconcile it. One of the large surveys we did last year was about data, payments, and monetization. In this chart, you'll see that corporates are willing to pay for real-time cash forecasting, automated reconciliation, real-time cash balances, etc. because they are perceived as a value. It's not just P2P and a one-off transaction. For many banks, it's amongst the most profitable part of their business because it's all fully automated. As volumes go up, the costs are relatively fixed, so the margins just improve and improve."

The U.S. remains a long way behind but has great opportunities ahead 49 years and 50+ countries to learn from:



Source: Celent September 2022

TCH RTP® Network Statistics:

Majeske shared the latest RTP network statistics:

- They're 277 banks on the RTP network
- 65% of US DDA accounts are covered
- There have been 330 million total transactions from inception (November 2017) through August 2022
- The 2022 YTD total transaction value is \$46.5B
- The average transaction value is \$447
- 45% of U.S. consumers have sent or received an RTP payment to date
- RTP is being used 24/7. With the bulk of payments being made between 6:00 a.m. and 9:00 p.m.

"While the bulk of transactions are heavier during the 6:00 a.m. – 9:00 p.m. timeframe, there are also plenty of transactions coming in at 3:00 a.m. This tells me that people are banking when they want to bank, and it's important that we have that service up and running for them," said Majeske. "In terms of some high-level use cases, what we're finding most prevalent in the U.S. are loan disbursements, gig economy payroll, and payroll in general (which is starting to shift toward real-time payments). Merchant funding is important so stores can get their funds faster. And for insurance, closing quickly on property and insurance claims from policyholders."

Majeske was part of the team that launched The Clearing House RTP network. “When we designed the RTP network, we had to design for now—and for in the future. I view RTP as a tool vs. a solution. With use cases, they’re using RTP, but that’s not the *solution*. I envision a reinvention of bill pay when it utilizes real-time payments. People are reengineering bill pay to make payments faster and more predictable in terms of document exchange. Using RfP for invoicing is an obvious application for commercial entities. However, I think we’re going to see a gravitation toward any type of document that needs to be signed, which is an opportunity for monetization. There is also a lot of talk about cross-border payments. I think a lot of customers do them—outside the bank. We’re creating applications where they can go back to the bank, for example, Visa Direct. And I believe that RTP and FedNow will eventually have a service for cross-border payments as well, including the handling of FX (foreign exchange).”

When to Charge for Instant Payments

When thinking about whether to or not charge for an instant payment transaction, Lodge suggested that the first thought be about the value given. “It’s understanding the need for short-term revenue versus the longer-term picture. When your bank has invested a lot of money in this, you don’t want to raise barriers and effectively never recoup your investment. It’s about what additional investment you need to make to get widespread adoption and, therefore, revenue.” Majeske agreed that a high perceived value of the transaction is key. “I’ll give you an example. PayPal uses RTP and offers it to customers who want to move funds from their PayPal account on the weekend to their bank DDA. PayPal customers have a choice—they can do ACH for free and wait or choose to make the transaction on the weekend (if eligible). The system automatically knows who is eligible because they know who their customers bank with. What’s interesting is that 70% of people who are given the offer take it and pay a fee. So I think that faster payments should be free, but I also think there are circumstances where sending money on a weekend, just like a FedEx box going out on the weekend, warrants a fee.

Use Cases

Buying a Car

When a customer goes into a car dealership on the weekend, and their bank or credit union is closed, what happens? They could go to the finance person at the dealership, and they could originate the loan. However, what if that individual wants to use the financial institution of their choice? That customer should be able to go to their mobile phone, apply for the loan, put in the VIN number, and perhaps be offered something like insurance, and do a turnkey transaction when the bank is closed. A customer should be able to go to a car dealership on a Saturday, purchase a car, and have the transaction completed with the funds actually sitting in the dealer’s account, which they can validate. There are benefits that aren’t immediately apparent as well. For example, if the dealer takes the instant payment instead of a debit card,

they're saving on transaction fees. They're not taking the risk of taking cash, thereby making lower insurance premiums possible. Lodge said that some countries are using more sophisticated solutions. "Some are using geolocation and geofencing to send a text message to customers at dealerships saying, 'Are you car shopping? Click here for an instant quote.'"

Buying a Home/Property

Unfortunately, buying a home can represent a large opportunity for middleman fraud. There have been cases where homebuyers were sent an email with wire instructions. Then they would be sent a second email saying that the previous email was incorrect and the transfer should be sent to another account, which would be to the fraudster. And it wouldn't be discovered until the buyer and seller parties were at the closing table. With real-time payments and RfP, that same scenario would play differently with everyone at the same table or online. RTP is currently offering a \$1m maximum transaction amount, which makes many purchases possible. The seller can send the RfP, and seconds later the title company knows that they've received the funds. The buyer also has the convenience of not having to go to the bank to initiate the wire. The transaction is both instantaneous and safe. Real-time payments have the potential of changing the industry—making it possible to close on a house on a Saturday, Sunday, or banking holiday, which wasn't feasible before. This is a use case that can be monetized by the bank. They can charge for this convenience, which would not be a shock as wires have fees as well. This example could go beyond houses and extend to basically any good e.g., factory goods with conditional payments, escrow accounts, etc.

Instant Document Execution

Using RfPs for invoices is a big option right now. But that could be taken a step further for contracts. The document, the environment to e-sign it, and the payment could be all in one message. Financial institutions could monetize this convenience by charging a fee for RfP contract delivery and/or execution and potential payment. Majeske reiterated that real-time payments is a tool. "They're not going to see RTP anywhere in this transaction, but the fact of the matter is, they're able to do it quickly and that becomes their new normal. When we talk about these use cases, we're talking about changing the user experience and making life easier."

Loan Disbursements

Loan disbursements are a very competitive space. There are a lot of different entities, banks and non-banks, that are starting to offer personal loans, auto loans, and other types of loans, etc.—online. The competitive advantage goes to those who can not only make the decision quickly but who can deliver the funds quickly. Real-time payments enable the FI to remain competitive, and they can charge for turn-key loan applications and execution anytime the customer needs the service. This can be included as part of the car buying experience or other online purchases.

Cosmos Payments

Majeske explained Alacriti's Cosmos Payments hub. "Important features include that it is a payments-as-a-service solution that's cloud-based. We integrate with many cores. Our solution is ISO 20022 native and uses APIs and smartrouting. This makes it compatible with any system. The available rails we have on Cosmos include FedWire, ACH, RTP (both Send and Receive), Visa Direct and Mastercard Send, and the FedNowSM Service when it becomes available mid-2023. We're also adding the capability of faster cross-border payment transactions as well. A key objective of ours is to remove friction for financial institutions to access rails and to be a one-stop shop for all payment rails available in the marketplace. It's a grow-as-you-go model, so rails can be added as needed, as well as just starting out for real-time payments with Receive Only."

Fraud, Funding, and UX

There are many considerations that financial institutions have when they consider entering the faster payments arena. Fraud is one of them, which brings attention to existing enterprise fraud systems and whether or not they're 24/7 ready. A lot of systems are not tuned for 24/7 operations. They're built for ACH and wire, which because they have more time, decision transactions can be in a queue. This is not the case with real-time payments. Alacriti is setting up a secondary fraud solution to augment existing fraud solutions that can accommodate real-time payment and offers 24/7 fraud detection. The solution is proactive, so transactions are analyzed and decisioned on the fly while the transaction's being created, rather than discovering the transaction is fraudulent afterward and having to work on getting the funds returned. Data can be used to make intelligent decisions before sending the transaction and customized around account takeover and identifying mule accounts. In addition, there is full-featured activity reporting and reporting for audits.

The need for liquidity management applies to both the RTP network and the FedNow Service. When a financial institution opens a sub-account on RTP to do transactions 24/7, they have to fund that account. In some cases, if there are not enough funds (e.g., on a three-day holiday weekend), the account could run to zero and not be able to send transactions. Financial institutions who also want to send are turning toward funding agents, which provide them with liquidity over the weekend if their sub-account levels go down to zero. This is something that Alacriti is also offering.

The customer experience is another area to consider. Alacriti offers customer-facing screens (UI/UX) to accommodate faster payment transactions. This is added through APIs where the financial institution could still brand it, but they could have a page from day one. This means that the customers have access to the network as well.

RTP vs. FedNow

Financial institutions that have not yet implemented real-time payments may be deciding between FedNow and the RTP network. Majeske suggested that it's best to do both, considering FedNow and RTP are not interoperable. "Given that, and that FedNow is offered for next year, my advice is to look at RTP today, which enables financial institutions to prepare for real-time payments. There are processes that have to be changed and touchpoints within the bank where people have to be aware of faster payments and how to treat them. So if I'm doing RTP first, I'm getting a leg up on FedNow when it comes out because I'll already have the infrastructure in place to support it." Lodge agreed. "We're advising our clients that getting RTP ready and getting those lessons and experience provides an advantage. And unless something radically changes, we're not going to see interoperability between the two systems for years—so it's inevitable that they'll do both."

Conclusion

Lodge had some parting advice, "If you're trying to solve the client's problems, the key is getting them on board at the beginning and showing them what's possible. The challenge with working with clients is when you ask them what they want, they want something cheaper or faster. If we had asked them a hundred years ago, they would have wanted faster horses rather than invent the car. So I think it's about going through the process of helping them understand that it's much bigger. A great starting point is doing workshops with your customers in different segments." Majeske added, "Oftentimes people will come to me and say, which rail should I choose? And I said, well, what are you going to do with it? Make sure you speak with your customers, go through your portfolio and segments of customers, and think about what you're trying to solve for. Because you have to design products around people who will use them. Learn about your customer's needs, how you're going to make their lives easier, and then choose the technology you want to use to satisfy it."

To learn more about the next steps for real-time payments and how to monetize them, watch the full webinar, **Real-Time Payments: How to Monetize and Stay Competitive**, featuring Celent and Alacriti.

WEBINAR PLAYBACK

Real-Time Payments: How to Monetize and Stay Competitive



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Alacriti's centralized payment platform, Cosmos Payments, provides innovation opportunities and the ability to make smart-routing decisions at the financial institution to meet their individual needs. Financial institutions can unify payment processing all in one cloud-based platform—ACH, the FedWire Funds Service, TCH RTP® network, Visa Direct, and soon, the FedNowSM Service. To speak with an Alacriti payments expert, please contact us at (908) 791-2916 or email info@alacriti.com

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