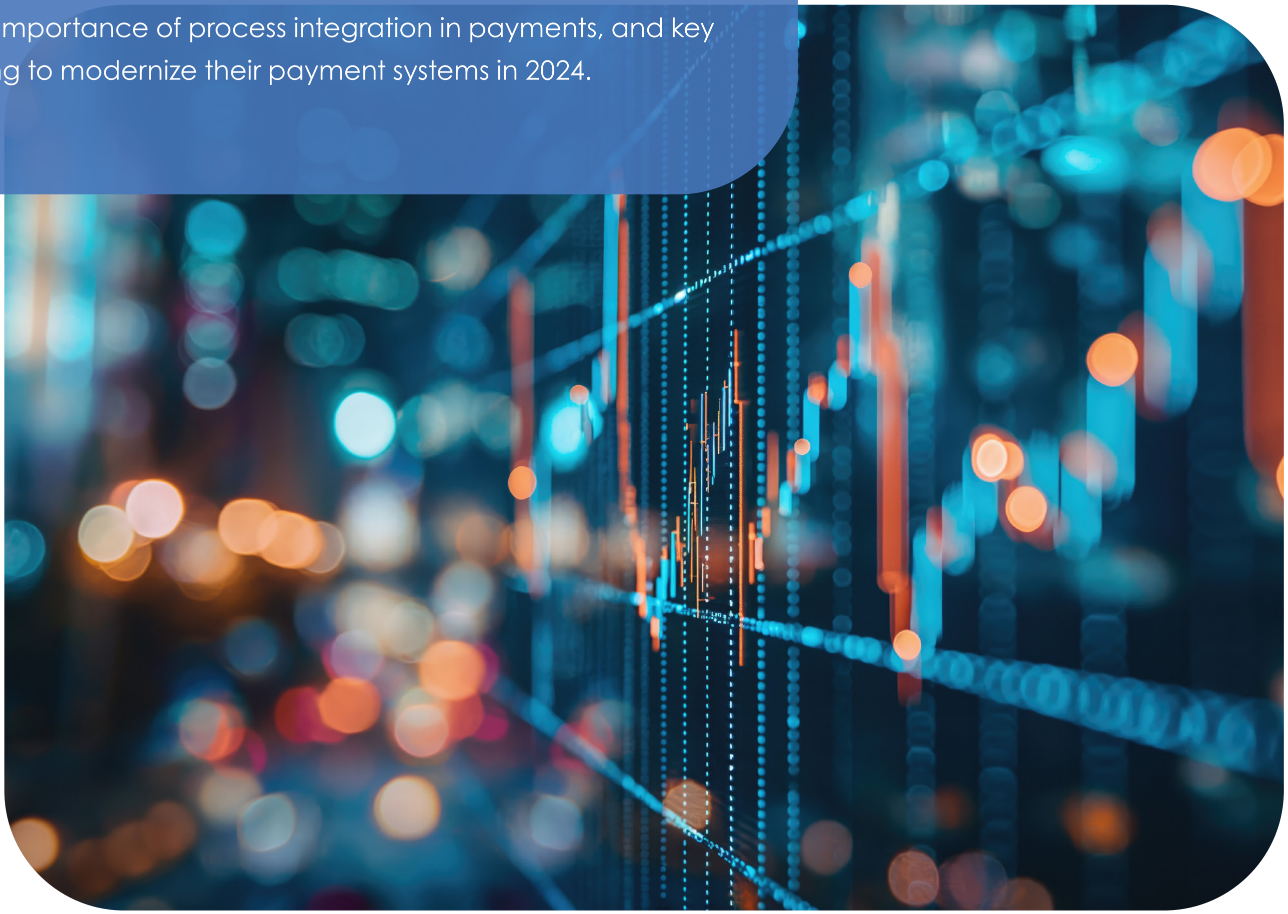
Alacriti

The Future of Payments: Trends and Challenges in Loan Payments and Modernization

At a time when rising interest rates are becoming the norm and the demand for a modernized money movement experience is on the rise, staying informed on the latest payments trends is essential. A webinar hosted by PaymentsJournal provided valuable insights into loan payments, process integration, and payments modernization. Industry experts Stuart Bain, SVP and Product Manager at Alacriti, and Brian Riley, Co-Head of Payment Strategies at Javelin Strategy & Research, discussed the impact of credit card debt and consolidation, the anticipated effects of regulations on loan volume, the importance of process integration in payments, and key considerations for bankers looking to modernize their payment systems in 2024.



Trends in the Market

Consumer loans are running strong in the U.S., but there are signs of tapering as rising interest rates become the new normal. Riley offered his perspective on what's going on in the market, noting a shift in consumer behavior. "There was a recent story in The Wall Street Journal. They talked about a shift in some of the retail habits that are normal this time of year," he said, pointing out a decrease in imports of bicycles and a stagnant hiring rate for retail workers. This suggests an anticipation of a challenging retail season.

The rising interest rates and inflation are putting a strain on consumer budgets. Riley observed, "Interest rates are at levels they haven't been seen for decades, literally 30 years. Inflation is still pretty heavy... When you look at loan volumes, they are up." He also expressed concern about the increase in loan volumes used for credit card debt consolidation, which can backfire if consumers don't close their high-interest accounts, potentially leading to further financial strain.

Delinquencies are another area of concern; as Riley pointed out, "Delinquencies are now twice the level of what they were in 2021." This, coupled with a gradual rise in bankruptcies, signals potential turbulence ahead for the industry. Bain speculated on the impact of high interest rates on consumer behavior. "If the high interest rates stay in place, we might see consumers pause and create inertia in the market," he said. He also noted the paradox of rising house prices despite the expectation of a decline due to increased interest rates, suggesting a possible supply and demand issue.

Bain further elaborated on the trend of loan consolidation, referencing data that showed a decline in non-revolving lending while revolving lending increased. "The data sometimes doesn't track against what we would expect to see. Non-revolving lending was down $30.3 billion which could be people paying off loans, but revolving lending increased. So perhaps it is that people are paying down their consolidation loans, but switching back to using their cards, and card usage will increase.

Regulatory Environment

The Credit Card Competition Act, also known as Durbin 2.0, requires cards from banks with $100 billion or more assets to offer merchants the choice of two unaffiliated card networks other than Visa and Mastercard. The intention was to lower fees and promote competition; however, critics say that it's a giveaway to retailers and would increase costs for consumers.

"The Credit Card Competition Act of 2023 would enhance credit card competition and choice in order to reduce excessive credit card fees. It would require the largest credit-card issuing financial institutions in the country—those with assets over $100 billion–to enable at least two credit card networks to be used on their credit cards instead of just one, and at least one of those networks must be a network other than the Visa/Mastercard duopoly. In other words, after a transition period during which the Federal Reserve would write implementing regulations, the giant banks that issue the overwhelming majority of Visa and Mastercard credit cards would have to choose a second competitive network to go on each card, and then a merchant would get to choose which of those networks to use to process a transaction. This competition and choice between networks would incentivize better service and lower cost; in fact, for more than a decade, federal law has required debit cards to carry at least two debit networks and this requirement of a choice of debit networks has fostered increased competition and innovation in the debit network market and has helped hold down fees."

Alacriti

Reflecting on the original Durbin Act, which regulated debit cards at institutions above a certain size, Bain noted the significant impact it had on reward-based debit cards. "The original Durbin Act, which regulated debit cards at institutions above a certain size, basically eliminated reward-based debit cards overnight," Bain remarked. This provides the potential for similar disruptions to credit card payments under the new legislation. The proposed act aims to introduce co-branded credit cards, challenging the dominance of major card issuers by necessitating two logos on each credit card to foster market competition. Bain pondered the practical implications of such a regulation, questioning, "Does the customer get to choose when they make a payment? Do I want to run this as a Discover or run it as a Mastercard?" He also raised concerns about the potential for tracking separate balances for accounting purposes, which could complicate credit card payments. However, given that the regulation is targeting the top ten issuers (the top ten banks), it won't impact many card issuers.

Riley weighed in on the broader regulatory environment, noting the influence of the political climate on such initiatives. "We're going into a presidential election cycle, and legislators, and they love to grasp onto topics like this," Riley observed. He referenced recent discussions in the Senate about capping credit card interest rates, suggesting that while such proposals may not gain traction, they highlight the vulnerabilities within the industry. The vulnerability stems from the fact that if write-off rates are going up, it will cut out a large amount of low or mid-range credit accounts from having access to the credit.

Riley also addressed the classification of delinquency fees as "junk fees" by the White House, emphasizing his opinion that these are contractual obligations rather than unnecessary charges. "They are contractual obligations, and they're there for a reason," Riley stated.

The CFPB has found that since 2010, issuers have generally been charging consumers more in credit card late fees each year—growing to over $14 billion in 2022 and representing more than 10 percent of the $130 billion issuers charged consumers in interest and fees. For some large credit card companies, late fees are a major driver of their profit model. The CFPB's rule applies to the largest credit card issuers, those with more than 1 million open accounts. These companies account for more than 95% of total outstanding credit card balances. CFPB data shows that smaller issuers tend to charge lower rates and fees to their borrowers, while the vast majority of the largest issuers charge close to the maximum allowable late fee amount.

Process Integration

Process integration in payments is emerging as a critical factor for success, especially as consumers increasingly demand instant gratification in all aspects of their financial transactions. Bain emphasized the importance of real-time processing, "Consumers have reached the point where they expect instant gratification of all things... the days of them having to wait two to three days for a payment to post to their loan, their credit card, their mortgage, whatever it might be, are sort of viewed as very old fashioned. We see a lot of feedback from prospects and clients saying they need to make the whole process faster for their customers or members just because the customers are demanding it."

This expectation of immediacy extends beyond loan payments to person-to-person payments and account-to-account transfers. Customers are questioning why they can't move money between their accounts in real-time if they can do so with services like PayPal. There is a need for payment service providers to facilitate real-time account

lookups, balance checks, and posting. “What’s essential there is the ability to talk to the cores in real time,” Bain asserted.

Of course, the 2017 launch of the RTP® network and the 2023 launch of the FedNow® Service have driven the shift towards real-time payments. The ability to decouple payment data from the actual dollars is crucial. “The money is going to show up, but you should be using the data to apply the payments rather than waiting for the actual dollars to show,” Bain advised.

Riley agreed, saying, “This is a really good time to get your house in order if you’re on the issuing side. And it really doesn’t matter what size you are as an institution. A lot of that has been democratized, and I think that’s an area where Alacriti has shined over the years and being able to make sure those fundamental parts of the business are in place and working in the right way and making sure customer satisfaction is at its highest.”

The move towards real-time payments poses unique challenges for different types of lending products. While mortgage payments may continue to be applied in cycles, credit card payments are likely to see more significant changes. “If I make a payment, when do I get to spend that money again? If I do a payment this morning, can I go out and spend the $363 this afternoon?” Bain asked. This introduces additional risk management challenges, raising questions such as: Is this actually a genuine payment? How far do you push it? How far do you open up the open to buy? Opening the open to buy is highly significant as it allows the customer to get back into their credit line faster. By doing so, it increases the ability to generate interchange revenue and also interest as the account goes on.

“This is a really good time to get your house in order if you’re on the issuing side. And it really doesn’t matter what size you are as an institution. A lot of that has been democratized, and I think that’s an area where Alacriti has shined over the years and being able to make sure those fundamental parts of the business are in place and working in the right way and making sure customer satisfaction is at its highest.”

Brian Riley
Co-Head of Payment Strategies,
Javelin Strategy & Research

Alacriti

The Importance of Payments Modernization

Making the case for not updating processes and technologies is hard as modernization has become even more crucial. When bankers consider modernizing their processes and technologies, Bain listed six top things that they should do.

1. Improving the customer experience, particularly in the context of real-time payments. "Consumers, especially following the pandemic, have basically all gone electronic. So it's speed and convenience across the value chain," Bain explained. There's a need for full visibility of transactions and immediate availability of funds as key components of a modernized payment system.
2. Accelerating innovation is possible with real-time in place. "The Clearing House has basically said, we're just providing the network. We'll let the fintechs and the banks work out how to develop products off the ability to move money in real-time. There are some interesting concepts out there about how you could use those networks to create new payments experiences. For instance, would somebody come along and start to issue a new decoupled debit card? Because they can actually check the balance on the account in real-time, they can get the funds in real-time."
3. New standards, such as the Fed's adoption of ISO 20022, are coming, and financial institutions need to be prepared for these changes. "Some of the banks that we work with have started having to divert budgetary funds away to deal with that because their current core systems aren't in place. Whereas Alacriti's Payments Hub offers full ISO 20022 support, including for Fedwire."
4. Understand how the regulatory environment will impact the banking industry, especially with respect to the Consumer Financial Protection Bureau (CFPB). Bain predicted that they would start scrutinizing fees beyond just credit cards, potentially affecting other types of fees viewed as onerous for consumers. Bain highlighted the shift in regulatory agencies' focus from safety and soundness to consumer-facing pieces and the importance of keeping up to date with the core system.
5. Cost reduction, according to Bain, is the biggest driver of payments modernization. Many of the legacy technology stacks are expensive, running on big, expensive IBM hardware that has to be hosted and maintained by people. They are also slow to adapt. The change cycle on these legacy products is not measured in months but in years. They require specialized skill sets that are reduced in availability as people retire and are not being replaced by new people. "Why wouldn't you want to modernize your platform and the whole infrastructure that surrounds it?" Riley asked. In addition, one of the most cited benefits of moving to real-time is the lower cost of transactions.
6. Manding liquidity and working capital efficiently to deploy funds more effectively—making it possible to move money around more efficiently in real-time between different financial institutions. Bain noted a latent demand for real-time payments, as Alacriti clients see payments more or less immediately as soon as their routing number is activated on one of the networks.

Money Movement

The shift toward real-time payments has affected money movement overall. "We've reached the point where payment options like ACH debits and cards are pretty much commodity items," Bain explained. "So what can we do better than that? That's where things like real-time come in, specifically from a loan and bill payment perspective."

The rollout of the FedNow Service and the RTP network is driving the demand for services like Request for Pay (RFP), which offer guaranteed and immediate funds availability for high-risk transactions. "Going back to delinquencies and accounts that are in trouble, would you rather do an ACH and not know whether the money is going to show up because you might get an insufficient funds or do an RfP where the money is guaranteed?" Bain asked. The benefits of RfP cover more than just bill pay; it can also have applications for account-to-account transfers and new account funding. For example, using it to fund a brokerage account without risk.

Bain also touched on the potential for alias-based payments, where consumers can send money using an email or cell phone number instead of bank account details. This raises the question of network interoperability. For example, someone on PayPal can send money to someone on Zelle without any hoops.

Riley emphasized the innovation of push-to-card payments and the significant growth of card usage in the U.S. "We did a study recently, and the population growth in the last ten years was 5.2% in the U.S., *but card growth was 42%*." Push-to-card payments has the potential to go beyond banking and go through the whole ecosystem of any company that needs a payment or wants to have a relationship. Some of the more forward-thinking insurers are moving away from mailing a check. For example, someone pays their claim with a debit card, and the insurance company gives the claim straight back to their debit card. Two-factor authentication also lowers the risk of transaction disputes. Bain predicted that there may be some innovation in account-to-account transfers as well.

The payments industry is far from static—and financial institutions must stay ahead of the curve to meet the growing demands for instant and seamless money movement experiences. Riley and Bain demonstrated the importance of modernizing payment processes, embracing real-time capabilities, and adapting to regulatory changes. Embracing these trends will enhance customer and member satisfaction and ensure operational efficiency and competitive advantage.

To learn the latest in loan payment behaviors, process integration advancements, and payments modernization, watch the full webinar, 2024 Payments Landscape: Strategies for Loan Payment Success, hosted by the PaymentsJournal and featuring Javelin Strategy & Research and Alacriti.

Alacriti's Orbipay EBPP is a customizable electronic billing and payments solution for businesses and financial institutions of all sizes. Orbipay EBPP offers convenient and flexible choices that include all the payment channels, payment methods, and payment options expected from a modern digital bill pay experience. To speak with an Alacriti payments expert, please contact us at (908) 791-2916 or info@alacriti.com.