



OUR PERSPECTIVE

Achieving a Ubiquitous Faster Payments Capability in the U.S.

BY STEPHANIE HELLER AND ROB HUNTER, TCH, AND RICHARD TAFFET, MORGAN LEWIS

The race is on to achieve a ubiquitous faster payments capability in the U.S. that promotes efficient commerce, facilitates innovation, reduces fraud, and improves public confidence. When the Federal

Reserve first began focusing in 2015 on the need to improve the U.S. payments system to achieve this goal, it decried the fact that there was then “no ubiquitous, convenient and cost-effective way for U.S. consumers and businesses to make (near) real-time payments from any bank account to any other bank account.”¹ Much has been achieved in the intervening three years at many levels of the payments ecosystem, with new entrants offering faster payments capabilities, which when taken together provide a strong foundation for realizing the Federal Reserve’s objectives.

“Achieving ubiquity is not just an academic aspiration. Although all of the Federal Reserve’s goals for faster payments are important, ubiquity clearly stands out.”

However, if the U.S. is to realize a successful faster payments environment by the Federal Reserve’s target date of 2020, all with an interest in achieving this goal must recognize certain basic truths. The U.S. payments system is complex, involving myriad participants with many different, often interrelated and interconnected market segments. At its core, however, a payment “rail” over which interbank transactions are cleared and settled must support a faster payments system. In November 2017, The Clearing House launched its RTP system, the first payments rail introduced in the United States in over 40 years. It offers 24/7 real-time clearing and settlement capabilities, coupled with enhanced messaging functionality compliant with the leading international

standard, ISO 20022. As such, the RTP system not only is a new entrant competing with existing payment rails – i.e., wire, Automated Clearing House, and checks – it has already created and facilitated new competitive opportunities throughout the payments ecosystem.

More specifically, also like existing systems, a faster payments system must support “front-end” applications and networks that customers can use, and which then clear and/or settle over the payment rail. The RTP system is specifically designed technologically and by its rules to support interconnectivity and innovation. Direct participation is offered to financial institutions of all sizes on the same commercial terms. Participants can connect directly or through their core processor, and can work with a banker’s bank or corporate credit union to help manage their funding, liquidity, and other issues. Other payment services, such as Zelle (which does not currently offer real-time settlement) can ride the RTP rail and achieve that goal. Payments service providers engaged in the business of handling money transmission transactions are also permitted to leverage the capabilities of the RTP system.² All of these entities have the incentive to create, and are in fact creating, new faster/real-time payment products and services that will be or are capable of interconnecting with the RTP system and, regardless of use case (e.g., business to business, consumer to business, business to business, person to person) or medium (e.g., mobile device, PC, tablet, etc.), contribute to an end-to-end real-time payments environment.

Anyone assessing the capabilities of a real-time system anchored by the RTP platform must understand these complexities if a faster payments system is to succeed within the Federal Reserve’s time frame. Indeed, understanding these complexities is particularly important if the cornerstone of a successful faster payments system is to be achieved – that is, ubiquity, by which we mean the ability of the greatest number of users to interact over a faster payments system in connection with the greatest number of use cases.³ Put

differently, if a faster payments system is going to succeed, positive network effects must be achieved, which occur when an ever-increasing number of users are attracted to the system.⁴ This, in turn, provides incentives for the development of new and innovative products and services to meet the demands of consumers, businesses, and other potential users of the system.

Achieving ubiquity is not just an academic aspiration. Although all of the Federal Reserve’s goals for faster payments are important, ubiquity clearly stands out as an objectively established desired outcome for faster payments. For example, one Federal Reserve study revealed that 61% of consumers and 67% of business agreed that they “won’t use a payment method unless it is used and accepted by most people and businesses.”⁵

However, to achieve ubiquity and the positive network effects that come with it requires recognition that merely supporting a multitude of options at all levels of the payments ecosystem may retard the progress already being made in the marketplace and thereby deter the overall competitive benefits that a ubiquitous faster payments system will provide.

For example, competition among providers of “front-end” faster payment products and services is consistent with the goal of ubiquity. This would include competition involving products and services being developed and offered by many of the private sector companies (including Dwolla, Mobile Money, and WingCash) that submitted 16 proposals to the Federal Reserve’s Faster Payments Task Force, which was created to evaluate how best to achieve an improved U.S. payments system. It would also include the products and services being introduced by private sector companies that did not submit their solutions for evaluation or did not consent to their submissions being made public, including Zelle, which is offered by Early Warning Services; Popmoney, a payment service offered through CheckFreePay Corporation; Visa and MasterCard’s OCT system; and

a host of other solutions offered by FinTech companies, including Square, PayPal, and Venmo. All of these provider solutions (and others not yet developed or offered) in one form or another play a role in meeting the Federal Reserve’s goal for convenient and cost-effective ways for U.S. consumers and businesses to make “near” real-time payments, and all provide innovative ways to meet the payment needs of consumers and businesses.

None of these solutions, however, provide the core infrastructure for the settlement of real-time interbank transactions, which is supported, for example, by the RTP system. RTP, however, is what facilitates the competition among the “front-end” service providers; it is intentionally designed to allow these solutions to ride on top of and interconnect through the RTP platform. This allows the products and services offered by the “front-end” providers to “expand” their reach – because of the network effects that are created – which will drive the ubiquity of faster payments. In turn, users – both payers and payees – will benefit from continuing innovation and the introduction of new faster payments products and services by the solution providers as more users rely on the platform and drive demand for new innovation.

To achieve ubiquity, and as a result greater competition within a faster payments environment, the role played by a core infrastructure faster payments platform such as RTP must be analyzed differently. The RTP system plays two important roles in driving competition. First, it is an alternative to the existing wire, check, and ACH payment rails. Second, it creates the platform through which payment solution providers can interconnect, which allows otherwise disparate payers and payees throughout the ecosystem to make payments that would not be possible absent the centralized platform. This is critical for achieving ubiquitous faster payments. Unlike front-end products and services, because of the coordination role played by platforms such as RTP, a multiplicity of core infrastructure real-time payment platforms that perform settlement could cause fragmentation,

STEPHANIE HELLER, ROB HUNTER, RICHARD TAFFET

Stephanie Heller is Executive Vice President and General Counsel at The Clearing House, Rob Hunter is Executive Managing Director and Deputy General Counsel at The Clearing House, and Richard S. Taffet is a Partner at Morgan Lewis.

forcing payment solution providers to choose between different platforms or increase costs for such providers because of the need for redundant interconnectivity, thus depriving users – for all use cases – the ability to make payments to counterparties that would no longer be on the same payments platform. Interoperability among faster payment core infrastructure platforms as a means of avoiding fragmentation is unrealistic given the characteristics of faster payments and the technical and practical hurdles that would have to be surmounted.⁶ The inevitable result of fragmentation is the diminished ability of payment solution providers to broadly interconnect with each other, reduced opportunities for disparate payers and payees to make payments, and increased costs. Ubiquitous fast or real-time payments will at least be slowed, if not undermined entirely.

The U.S. is blessed with many innovative payments solutions that could support the Federal Reserve’s goal of faster and real-time payment ubiquity.

The U.S. is blessed with many innovative payments solutions that could support the Federal Reserve’s goal of faster and real-time payment ubiquity. Reaching this goal is not a certainty. Getting there will take time, and existing efforts already underway, like RTP, must be given the opportunity to take root and achieve positive network effects. This will permit competitive opportunities throughout the payments ecosystem to expand, driven by market forces, and the demands of consumers, businesses, and all payments system users will be met. ■

ENDNOTES

- 1 United States Federal Reserve System, “Strategies for Improving the U.S. Payment System,” at 8-9, January 26, 2015. <https://fedpaymentsimprovement.org/wp-content/uploads/strategies-improving-us-payment-system.pdf>
- 2 “Real-Time Payments Operating Rules,” § 2(H), The Clearing House, October 30, 2017. <https://www.theclearinghouse.org/payment-systems/real-time-payments/-/media/6de51d50713841539e7b38b91fe262d1.ashx>
- 3 This is in accord with the Federal Reserve’s definition. See Federal Reserve System, supra note 1, at 9, 28-29. “Ubiquitous participation refers to payment products that are broadly accessible by everyone and available to be used in a variety of different circumstances.” Id. at 9, n. 9.
- 4 Network effects occur when ever-increasing numbers of users rely upon a system; as use increases, overall costs of the system decrease and implementation efficiencies increase. See John Weinberg, “Network Externalities and Public Goods in Payment Systems,” November 1997, at 2 (“The value of a payment instrument depends on the extent of the network with which it connects”). https://www.minneapolisfed.org/research/conferences/research-events---conferences-and-programs/~-/media/files/research/events/1996_12-03/Weinberg_PaymentSystems.pdf
- 5 Federal Reserve System, supra n. 1, at 29.
- 6 Reliance on analogies to the ACH system to support calls for interoperability are misplaced. The ACH system developed out of paper check processing and the goal of moving to electronic clearing and settlement at a time when there were no significant retail electronic systems, no established legal framework, and interstate banking as we know it did not exist, all resulting in a payments system that was more geographically regional in nature. The relatively clean slate that existed at the time allowed for comparatively speedy development of a common rule set, message standards, and use of the Federal Reserve to provide a shared settlement infrastructure across regional boundaries. In contrast to the ACH, more than just geographical boundaries must be overcome. Systems have already well-established formats, unique payment and messaging characteristics, established legal structures (that can vary significantly between systems), and the real-time nature of the payment introduces enormous operational and other complexity that would be difficult to overcome. Interoperability in the present context would be more akin to being able to send a Fedwire payment over CHIPS, where the two systems have radically different characteristics in terms of how they clear and settle payments that would be virtually impossible to reconcile.



Our Perspective. Your Vision.

Promontory, an IBM Company, provides unique insight and advisory services that help industry leaders confidently navigate complexity at the intersection of strategy, risk management, and regulation.

About Promontory

We excel at helping clients resolve critical issues, particularly those with a regulatory dimension. Our deep domain expertise, combined with IBM's world-class technology, allows us to address challenging national and cross-border issues in banking, securities, commodities, financial instruments, markets, and insurance.

More at promontory.com

