The U.S. Instant Payments Landscape

Opportunities For Financial Institutions

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INTRODUCTION

The U.S. payments business generates hundreds of billions of dollars in revenues to banks, payment networks and service providers.[1] Instant payments represent the first fundamentally new payment capability in the U.S. in over 40 years. It is the result of modern technology being applied to payments to deliver the “always on, instant gratification” experience consumers and businesses have come to appreciate.

It is also an opportunity for these enormous payment revenues to be re-allocated to those who find innovative ways to deliver payments instantly to consumers and businesses.

True instant payment schemes move money from one bank account to another in real-time, irrevocably.

Consumer P2P services such as PayPal, Venmo and Cash App appear to move money instantly. In reality, payments on these platforms simply involve a ledger entry making one account go down and the other go up. Another transaction is required to move money from these services to a consumer’s bank account and often takes days to settle. Zelle improved on this experience by making money immediately available in a consumer’s bank account, but it leverages ACH, debit or wire and settles transactions in batch at the end of the day. The recently announced “Zelle over RTP” creates an instant experience end-to-end, but is only used in a small percent of Zelle transactions.[2]

RTP and FedNow are the two Instant Payment rails in the US. RTP launched in 2017 and is now being used by about 250 Financial Institutions. FedNow launches in 2023 and, while similar to RTP, will have different capabilities and aspirations. Between these two rails and other efforts to speed up payments (e.g. same day ACH, push to card), there is no doubt that instant payments will be part of the US payments landscape.

In countries where instant payments have seen significant adoption, FIs who were early adopters enjoyed significant new revenues. The Brazilian Instant Payment system, Pix, is a prime example. It launched in 2020 and there are now over 2B Pix transactions per month received or sent by over 70% of adults.

This white paper explores the landscape of instant payments in the U.S., how it will evolve for what use cases and ways FIs can monetize this new payment capability.

1
https://www.mckinsey.com/~/media/mckinsey/industries/financial%20services/our%20insights/the%202021%20mckinsey%20global%20payments%20report/2021-mckinsey-global-payments-report.pdf,
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https://www.theclearinghouse.org/payment-systems/articles/2021/02/02252021_zelle-over-rtp-network#:~:text=Early%20Warning%20Services%20and%20The,on%20the%20RTP%C2%AE%20Network&text=New%20York%20%26%20Scottsdale%2C%20AZ%20%E2%80%93,over%20the%20RTP%C2%AE%20network

INSTANT PAYMENTS EVOLUTION

The shift to instant payments in the U.S. is being driven by the market, not by mandate or regulation. This has resulted in slower adoption overall.

While there are over 200 FIs participating in RTP, only around 20 send and receive instant payments; the majority only receive them. “Receive only” is significantly easier to set up as it doesn’t require changes to the end user’s digital experience, and there’s less core integration, minimal changes to liquidity management or back office systems. But, a vibrant instant payments scheme requires the majority of participants to both send and receive.

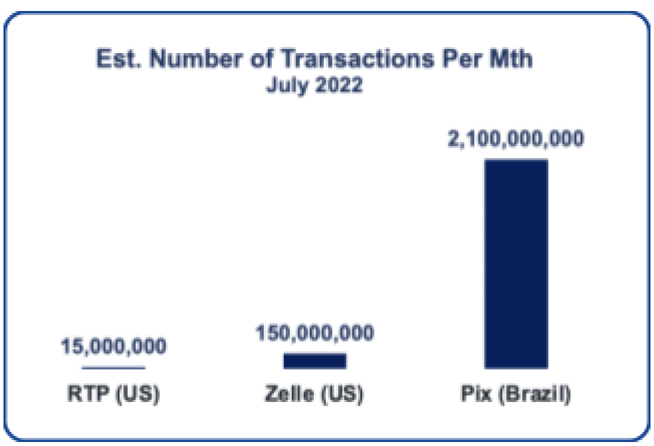
The Clearing House, an entity owned by 23 of the largest banks, operates RTP. They reported that there were 41.2M instant payments transactions in Q2 2022 worth $18B.

FedNow is a second U.S. Instant Payment rail that will be offered by the Federal Reserve by July 2023. Any financial institution can become a part of either RTP or FedNow, but none are obligated.

FedNow was driven by the Federal Reserve primarily as a real-time payment option for smaller banks who were reluctant to do business with RTP, a company run by the largest U.S. banks. The key difference between the two schemes is that RTP requires FIs to provide up-front funding to enable transactions. With FedNow, FI’s can use the funds in their master account already on deposit with the Federal Reserve.

The adoption of instant payments has been slow in the U.S. relative to other markets, but the growth of Zelle’s P2P service is a strong statement that consumers value quicker delivery of funds into their bank account. Even though Zelle isn’t technically an instant payment scheme, they are now processing an estimated 150M transactions per month, 10X that of RTP.

The potential for instant payments in the U.S. is huge as seen by the adoption in other markets. In Brazil, the number of Pix instant payments transactions is over 2.1B per month.



Instant Payments:

- Real-time funds availability
- Direct to bank account
- Credit push only
- 24 X 7 X 365
- Request for payment
- Rich messaging

Source: Industry experts, Zelle, Central Bank of Brazil

USE CASES

Instant payments use cases with the most traction in the U.S. are business-related, specifically P2B. Cash-outs, early wage access and payroll are a few popular use cases facilitated by RTP.

CASH OUTS

Funds held on account at P2P, loyalty and wallet apps can be transferred to a consumer's bank account with full availability before they can log off of the platform. This real-time availability of payouts is popular even when there are fees. Coinbase, PayPal, Venmo, and CashApp offer cash outs via RTP.

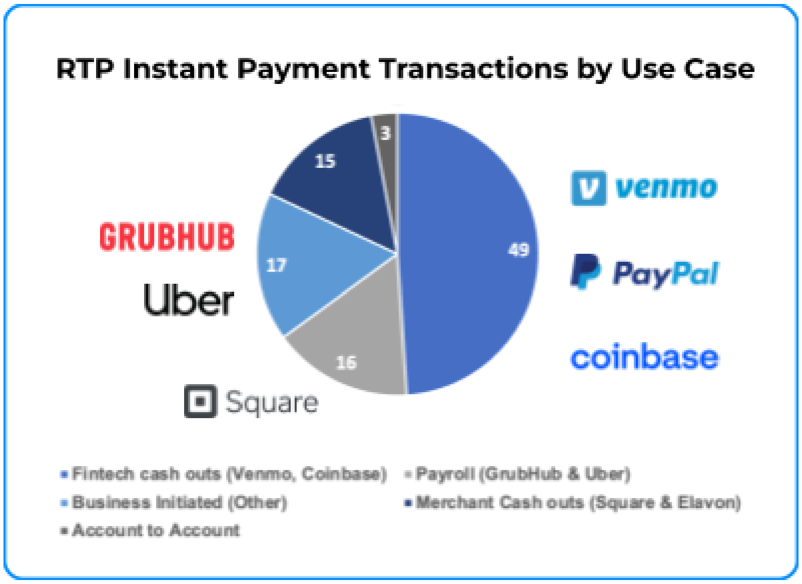
EARLY WAGE ACCESS

Paying workers the same day after they work is especially attractive for gig workers. Employers are using early wage access to attract attention in a tight labor market. Walmart, Uber, and Subway are three companies offering early wage access.

PAYROLL

Payroll processing can be complex. In some cases, pre-funding is required, and one-off payroll situations occur. Instant payments enable corporations to not only process regular payroll, but handle emergencies. The State of California has a requirement that employees who are let go must be paid in full before they walkout the door. ADP has an instant payments product that enables this use case.

For instant cash outs, Venmo charges 1.75% of the amount transferred with a 25-cent minimum and $25 maximum.[3] Coinbase charges 15% of the transaction amount for anything up to $10K. Anything over $10K is a flat fee of $150. The minimum fee is $0.55.[4] **A surprisingly high percentage of these cash outs are instant payouts generating new revenue opportunities.**



Source: The Clearinghouse

[3] https://help.venmo.com/hc/en-us/articles/115015844068-Instant-Bank-Transfer-FAQ
[4] https://help.coinbase.com/en/coinbase/getting-started/add-a-payment-method/instant-cashout

Other use cases that are expected to catch on include recurring subscriptions (e.g. Netflix) as these merchants will value receiving their money instantly and irrevocably. Collections also meets a well-defined need. Consumers who are late on their utility bills will pay a premium to pay instantly to keep their lights on.

After hours vehicle sales, property closings and rush product orders are additional future use cases.

As for B2B, businesses will be able to take advantage of increased accuracy and rich messaging associated with instant payments so they can do things like automate reconciliation which translates into real cost savings. There is a great opportunity for financial institutions to act as enablers for these B2B use cases which are just beginning to develop.

There is no limit to the ways consumers and businesses can make instant payments. The Federal Reserve recently hosted a FedNow Early Adopters Readiness Workshop where attendees brainstormed countless use cases. Many are outlined in these two documents.

FUTURE CAPABILITIES AND TECHNOLOGY FOR INSTANT PAYMENTS

Additional capabilities and technology are critical to adoption in the U.S.

- **Directory for P2P**
  Instant payment schemes in the U.S. today rely on the receiver to share their bank account and routing number with the sender. This exchange of confidential information only works in a limited set of use cases like B2B and P2B recurring bill payment. Consumers are unlikely to share this information with a friend, much less someone they don't know. A directory allows users to associate an alias to their financial account. This alias could be a phone number, email address or randomly generated string of characters. Consumers are much more comfortable sharing an alias for payment so their bank account and routing information are never exposed.

- **QR Codes for P2B Point of Sale and eCommerce**
  QR code generation and payment drive efficient checkout processes when consumers want to pay instantly in-store or online. Rather than having to share their bank account information or alias, consumers can scan a QR code with their mobile phone at checkout. This opens the consumer's mobile banking app where they confirm the purchase for Instant Payment. QR codes include all the information the merchant needs to reconcile the payment. It's as easy as collecting cash in-store, but is done digitally via QR codes. It's less expensive for the merchant to process instant payments via QR codes than any other form of payment.

HOW FIs DERIVE VALUE FROM INSTANT PAYMENTS

The opportunity to make money on instant payments is primarily on business-related applications. (e.g. B2B, B2P and P2B).

Businesses understand that money management and movement costs money. They are willing to pay for services that meet their primary objectives – visibility, availability, data, and reconciliation. Financial institutions that offer the best Instant Payment products that deliver on these objectives will crack the economic model of instant payments.

- **P2P**
  The success of business-related schemes does depend on consumers becoming familiar with instant payments which means enabling P2P use cases. However, it's unlikely that consumers will be charged which leaves little revenue opportunities in P2P. The good news is that processing Instant Payment P2P transactions is significantly cheaper to FIs than checks, Zelle or other means. In sum, the economic value to FIs of P2P instant payments is in reducing costs.

- **P2B Wallet Funding**
  Banks supporting merchants with mobile wallets (e.g. Starbucks) have an enormous opportunity to leverage the Request for Payment capability to enable consumers to fund their mobile wallets. If a consumer funds their Starbucks wallet instantly, this is a huge benefit to Starbucks. They get their money immediately and irrevocably, two benefits Starbucks will likely pay an amount to their bank that is comparable to credit card interchange.

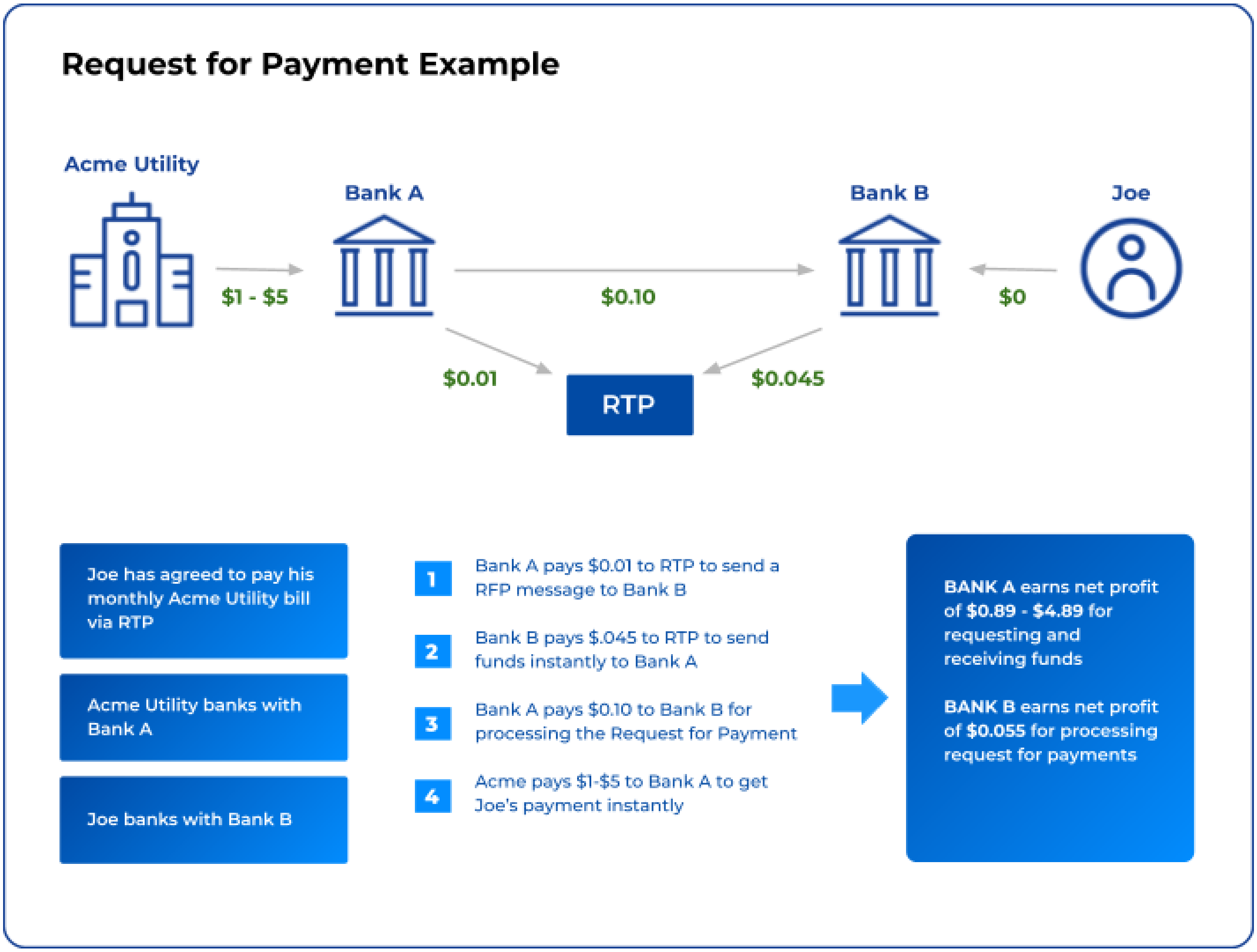
- **P2B Bill Payment**
  When it comes to bill payment, Request for Payment allows a biller to ask a consumer to pay a bill through the consumer's bank. Both the biller's bank and consumer's bank earn fees for this transaction.

  Just as FIs charge for payment processing and lockbox services, they can get paid to facilitate an Instant Payment to a biller in response to a Request for Payment Message

  Based on an overall bill payment market of $4.6 trillion, every 1% of bill payments transitioned to Request for Payment represents $46 billion in new fee revenue for participating financial institutions.[5]

  The diagram below provides an example of the typical fees paid on a request for payment transaction based on the current RTP fee schedule.

[5] Precedence Research



- **B2B**

  Large billers receive millions of payments each month. Reconciling a payment to properly credit the correct account is a critical business process. Payments via ACH, card and check often fail to provide accurate reconciliation information, requiring costly manual reconciliation processes.

  Instant payments provides specific [ISO 20022 message types]() which enable reconciliation information to flow along with the payment. These messages flow through the financial institution.

  Just as the institution can charge for processing payment requests, they can charge for processing the supporting messages.

  With over 60% of companies seeking to increase efficiencies in payment reconciliation, businesses will willingly pay for this accurate information to flow along with the payment.

- **P2B eCommerce and in-store purchases**
  Significant revenue opportunities will be in play as instant payments become commonplace in P2B ecommerce and in-store purchases. Large card issuers, payment networks (e.g. Visa/MC) and merchant acquirers in the U.S. have the potential to be cut out of the revenue stream related to processing instant payments. Or, they can leverage instant payment technology to find new sources of revenue and create better customer experiences.

  FIs and Fintechs who enable merchants to process instant payments will be empowered to set the prices for processing these transactions and won't have to share this revenue with multiple third parties. If the typical credit card transaction costs merchants 2% of the value of the sale, this revenue can now be earned by the FIs who enable instant payments.

  Many benefits accrue to merchants, including instant funds availability, reduced risk and lower fees. Merchants will value and pay for instant availability of funds. Consumer financial institutions can charge for innovative new services, such as purchase protection.

CONCLUSION

Instant payments present many revenue opportunities to FIs prepared to enable them particularly to their commercial customers. Banks can have direct payment relationships with merchants they service already. And, banks without revenues from cards can generate incremental revenue with instant payments.

Financial institutions in the U.S. have been disintermediated in the P2P space by companies like PayPal, in BNPL by places like Affirm and mortgage origination by players such as Rocket Mortgage.

Those with an aggressive strategy on instant payments can drive the direction and economic model to reap the benefits associated with this new payments capability.