Real-time payments needs more competition

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American Banker

January 16, 2019

The Federal Reserve has floated the idea of its entering the market for real-time interbank payments and invited public comment.

As a matter of public policy, the Federal Reserve shouldn't be a payments operator where the private sector can adequately and competitively serve. For instance, the Fed could enter the retail payments market, to try to lower costs for merchants and/or cater to small banks. But retail payments are fiercely competitive, well served by Visa, Mastercard, American Express, PayPal, Discover, Star, NYCE, Accel and more.

Where the private sector isn't adequately serving, the Fed should first look to facilitate it doing so, rather than itself processing payments. But if the Fed not providing real-time interbank payments meant a monopoly, it should step up.

Having a sole provider, even for what some might view as base payments infrastructure, isn't desirable. Monopolies can't match the market's dynamic intelligence and value creation. Markets self-correct, rewarding those that delight customers and punishing those that don't. Over the long haul even the most brilliantly designed monopoly systems underperform against seemingly inefficient and redundant competing providers.

In 2017 large banks' cooperative The Clearing House introduced a real-time interbank payments service. TCH and the Fed are the only traditional ACH and wire-transfer operators in the U.S. Part of the rationale for the Fed processing these interbank payments is to ensure a modicum of competition and that smaller banks have access. The same logic extends to real-time payments.

TCH priced its real-time payments identically for high-volume and small low-volume banks, at least partly to signal the Fed there was no need for it to enter the market, and putting an exclamation point on its complaint over the Fed discounting ACH for large banks.

In the absence of solid private-sector alternatives, the Fed would be a logical second real-time-payments processor. However, there are private-sector payment networks and processors with the wherewithal, and perhaps, the interest to compete in the U.S. instant-interbank-payments market.

Mastercard is the U.K.'s monopoly interbank real-time payments processor. It has direct or indirect processing relationships with U.S. banks large and small. And while not retail, interbank-payment processing, decidedly, is a network business. Assuming it's not restricted by its relationship with TCH, Mastercard would bring much to the domestic interbank-payments market, plus have a plausible path — or paths — to interoperability with national interbank-payment systems planet-wide.

Ubiquitous Visa, and FIS and Fiserv, using their debit rails, also provide faster payments. Interoperating with other networks, they all could provide systemwide instant interbank payments.

There would be a downside to the Fed entering the real-time interbank payments market. With its scale and role as the financial system's chief regulator, the Fed would deter additional private-sector parties from undertaking to serve the market.

Tech titans Google, Amazon, and Apple, and payments Phenoms PayPal and Stripe urged the Fed to provide real-time interbank payments. Yet they would howl in protest if Washington proposed providing internet search and retail-payments processing to ensure equitable access. In their realm, they understand having the state competing with private firms isn't in their or the public's interest.

Goliath retailers Walmart and Target want the Fed to provide faster payments. They would, however, be the first to object to government launching a national chain of big-box stores.

And, small banks are keen for the central bank to provide an instant interbank-payments alternative to TCH. The Independent Community Bankers of America declared ubiquity "may never be achieved without the Federal Reserve developing and operating a

RTGS service and interoperating with the private-sector solution" – in other words, TCH.

Having the Fed offer real-time interbank payments, would be better than relying on one private-sector provider. If the Fed develops a real-time interbank payments system to ensure system competition, it should ultimately sell it to a private-sector operator(s).

A dynamic instant interbank-payments market with TCH — and ideally a handful of other private-sector players competing — would deliver maximum societal benefit.

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