The Real Deal for Real-Time

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Multiple real-time services may flourish, but don't discount the Fed's ability to corner volume.

Over the last several decades, there has been a crescendo of interest from regulators and the industry worldwide in real-time interbank payments. Instant interbank payments displace batch automated clearing house transfers and enable new use cases, improving economic efficiency and enriching society writ large.

While the United States wasn't an early adopter, its real-time interbank-payments market is developing apace. The Clearing House Payments Co. LLC (TCH), owned by many of the nation's biggest banks, launched its real-time payments system, RTP, in 2017.

In reaction, the Federal Reserve contends that, since there's only one private-sector instant-payments operator, it's imperative the Fed itself provide competition and system resiliency, as it does with ACH. The Fed has disingenuously argued that, because other instant-payment systems don't provide interbank real-time gross settlement, they weren't TCH competitors. If markets are defined narrowly enough you can always conjure a monopoly.

The Fed's plan is to have its FedNow real-time payments network live by 2023 or 2024.

Meanwhile, bank cooperative Early Warning Systems' instant account-to-account-payments network, Zelle, went live in 2017. And, leveraging their "card" rails, Visa, Mastercard, Discover, Fiserv, and FIS provide instant interbank credit-push payments. Visa's and Mastercard's products, Visa Direct and Mastercard Send, reach billions of demand-deposit accounts planetwide.

The field will broaden further with nontraditional competitors.

For example, Chase's and Signature Bank's dollar-backed stablecoins, JPMCoin and Signet, enable faster payments between their institutional clients. Their systems could be opened up to other banks.

Facebook's Libra will support the real-time exchange of tokens representing dollars. And, when the Fed introduces a digital dollar—ideally distributed through rather than competing with banks—it will be another instant-payment system.

In the meantime, TCH's RTP is building network critical mass. It has relationships reaching 70% of U.S. DDAs, though not all are yet switched on. While many community banks distrust TCH, they can ill afford to wait on FedNow. That would deny their customers services and cost them deposits and customers.

TCH priced RTP to win over small banks. Banks pay 4.5 cents per real-time credit, a penny per request-for-payment, a penny per remittance advice, and a dime in bill-payer interchange per credit, regardless of volume. TCH had hoped to weaken the Fed's case that only the beneficent Fed could provide equitable access to community banks.

Thereby, TCH hoped to dissuade the Fed from entering the market. It was a good try that was never going to work.

Competitor Nonpareil

The Fed's actions should be viewed through the lens of Nobel-Prize-winning economist James Buchanan's Public Choice Theory, which holds that public actors act to maximize their own utility. Since its 1913 founding, the Fed has relentlessly amassed more power and increased the scope of its activities.

FedNow will be the first new Fed payment system in four decades. One hundred Fed employees are beavering away.

Initially, FedNow will support credit-push payments, request-for-payment, and liquidity management for banks' instant-payment programs. Additional features such as an alias directory will be added later.

But by 2023, TCH's RTP will be a mature, feature-rich system, and, directly and through third-party processors, it will likely reach 99% of U.S. DDAs. Use of the card networks' and Zelle's instant payments will be greater. Digital dollars may be in the mix.

By contrast, FedNow at launch will reach relatively few DDAs.

For a would-be private-sector competitor, the market would be sewn up, unless it had a compellingly better mousetrap. The Fed, however, is a competitor nonpareil. It's the central bank, the paramount financial-system regulator, and enjoys unlimited resources.

The central bank will muscle its way into the market.

How? Pricing. Mastercard and Visa price higher than TCH and target different use cases, for now. The Fed has a different approach in mind.

To win volume, FedNow will be priced below cost for more than a decade. No private-sector enterprise could do this. Moreover, when foreign companies price exports to the U.S. below cost, it's called dumping.

The Fed says FedNow "fees will be based on transaction costs associated with mature volume estimates." In 2018, the United States had 28.5 billion ACH payments, which, on the current growth trajectory, would be 38 billion in 2023. For instant and batch payments, the marginal processing cost is zero.

The Fed could decide the market won't be mature until real-time substantially supplants batch interbank payments and FedNow processes 20 billion payments annually.

Bending the Knee
Even aggressively priced, however, FedNow won't interest banks if it doesn't reach a critical mass of DDAs.

The Fed pressed TCH to pledge to interoperability. Thus far, the bank cooperative has demurred. Why would it help a competitor become viable? However, the central bank won't take no for an answer. It will assert interoperability is necessary to ensure critical U.S. payments infrastructure is resilient. TCH banks could refuse such a demand from a private-sector competitor. But they will have to bend the knee for the Fed.

FedNow's liquidity-management tool will facilitate banks using RTP and/or FedNow, providing credit among themselves to maintain funds to cover real-time payments outside Fedwire's hours.

The market's global. TCH's RTP and FedNow at some point will interoperate with other national real-time payment platforms. Mastercard, with its worldwide network and Vocalink and Nets faster-payments assets, is in the pole position to interconnect national real-time-payments platforms.

A patchwork of diverse, interoperating, and competing traditional and nontraditional domestic and cross-border systems augurs well for instant-payments value for banks, businesses, and consumers.

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