Vizant INSIGHT
from the Payments and Treasury Expert

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The Current Payments Landscape and Real Time Payments

The ecosystem of payments in the USA is built on the foundation of the Six (6) Core Payment Systems. These payment systems touch and involve every single dollar of payment movement in our economy. The six systems, in no particular order, are as follows: cash system, checking system, wire system, ACH system, credit card system and the debit card system. A new payment system has come on to the scene, called Bitcoin. The system is new, untested as to wide spread adoption, and is fraught with many challenges.

All of the many so called new payment systems, including ApplePay and the other mobile and online payments, must utilize one of the existing six systems to actually transfer value between parties. The similarities and differences amongst these payment systems are many, yet, except for cash, there does not exist a 'real time' or 'guaranteed' payment system in the USA. That may change in the future, as the government and the payments industry are finally working on solutions that could make payments real time or close to real time and 'good funds' as soon as the transaction is made.

The Cash System is the simplest and easiest of our payment systems and is anonymous. It is the only real time payment system. If you pay with or accept cash, the payment is good, cleared and confirmed real time. The only risk with a cash payment is counterfeit currency and that is rather rare. The problem with the cash system is clear: cash does not work in our electronic and online world. Despite the issues with the cash system, the cash transaction share of the financial payments market has actually been flat for the last 5 years.

The Checking System has been a staple of our banking and payments world for many years. Originally, a 100% paper based system, it now has e-check as a core component of the system. It is a system at its basic level where one party, consumer or business, makes a promise to pay the other party. With the checking system, the recipient of a paper or e-check transaction bears the entire risk of the payment being good. It is not a real time system, despite the fact checks clear faster today than they did ten years ago. The checking system processes far fewer transactions today than it did ten years ago. This is due almost entirely to the increase in the use of debit cards.

The Debit Card System has surged tremendously in the last ten years and has resulted in decreased use of the checking system. Debit cards and prepaid cards now account for more than 50% of payment card usage in the USA. The debit card system offers more protection to the payment recipient than the checking system, because the transaction is authorized in real time. However, the payment is not guaranteed. The transaction must still clear the payer's bank account and the payer can challenge the transaction. In addition, there remains a lot of fraud in the system.

The Credit Card System is controlled by the big 4 card networks and their issuing bank card partners. It is an enormous system with thousands of service providers and it is by far the most complex of the six core payment systems. It is also the most expensive system for the payment accepting organization. The credit card system

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has an onerous rate structure with wide variation in costs. The costs vary by: market or industry of the payment acceptor, size of the organization, the data sent with a transaction, the card processor, and many other factors. Like the debit card system, it offers real time authorization, but not real time or guaranteed funds. Payments can be challenged and reversed by the payer and there is also much fraud in the system.

The ACH System, which is owned by the banks, is an electronic funds system that is viewed by many as the driver to real time payments. With an ACH transaction, the clearing is no less than one day (not same day) and sometimes longer. Thus, an ACH payment initiated one day does not offer real time funds to the receiving entity or person until at least the next business day. The recipient of an ACH payment bears all the risk. There is an ongoing effort to enhance the ACH system so ACH payments clear in a single day and, ultimately, in real time.

The Wire System is actually a system for banks to transfer money to one another. The system cannot be used for entities or individuals to send money to each other directly. You must have a bank account within a bank to initiate a wire transfer from your bank or to accept a wire transfer from another bank. The system is not set up for repetitive and every day transactions for consumers. However, the system makes for a guaranteed payment. Once a wire transfer is initiated and sent through the system, it cannot be reversed. The funds are 'good' for the payment acceptor.

Some Questions to be asked?

- Is our economic world moving to 'real time' and 'guaranteed' payments?
- Do any of the six core payment systems have the ability for real time payments?
- Will a new payment system emerge that will solve all of the issues around payments?
- How expensive will a new payment system be?

The answers to these questions are not known at this time. While the core payment systems now control all of our payments, there appears to be momentum to remaking our payments ecosystem. Rest assured Vizant, as the thought leader in payments, will continue to partner with its clients to provide expertise and leadership in all aspects of receiving and initiating payments.

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Bringing Efficiency to Corporate Cash Management

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The concept of efficient corporate cash management is gaining ground amidst evolving technology and the explosion of management options available. Standardized payments terms are highly desired by businesses, and some companies have been striving to maximize the ease of corporate supply-chain management and payment options. The goal often is not to generate debt for the supplier, but to convert accounts receivable into cash faster. Early-payment discounts are another factor worth consideration by corporate treasurers, and a recent article in Treasury and Risk describes it as a perfect option for organizations that want to boost their returns on cash in the current low-interest-rate environment.

Moreover, businesses that host teams of purchasers and many suppliers typically have more than 100 unique sets of payments terms, some of which are idiosyncratic such as net-7-day or net-15-day with no early-payment option. Companies that fail to rein in their payment terms risk exacerbation of their days payables outstanding metrics. These issues add credibility to the contention that businesses should consider integration with an electronic invoicing platform, as a digital migration enables them to lower costs and the number of hours normally committed to manual data entry.

Treasury and Risk reports the combination of dynamic discounting and e-invoicing can enable organizations to implement an early-payment discount program before either solution is fully installed. “This ‘rapid ramp’ approach targets suppliers that either have offered discounts in the past or have never been approached with the idea of early-payment discounting,” according to the article. “For suppliers that agree to participate, the buyer initially assigns a mutually agreed-upon standard payment term and captures the discounts manually.”

From "Bringing Efficiency to Corporate Cash Management"
Pymnts.com (10/13/14)

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Fed Seeks to Clarify Payment Token Standardization

The U.S. Federal Reserve is concerned about myriad payment token standardization initiatives, with a report from the Boston and Atlanta Feds citing the development of differing tokenization models, inconsistent terminology, and their failure to address front-end fraud as problems. Another key issue is how businesses and merchants will work with tokens, in view of the degree and distinction of the various infrastructure change requirements. “Whether the tokenization standard adopted is EMVCo or non-EMVCo, businesses will need efficient and compatible solutions that have minimal impact to their operations,” the report noted. “Tokenization platforms that include format-preserving protocols, tokenization and encryption of data and files, centralized policy control, and simplified key management may help to address this issue.”

Also of concern is the card networks' proposed infrastructure framework, which essentially overlays the EMVCo specification while allowing for customization. Adding to the confusion are differences between static and dynamic tokens, as the former only change when the token expires, and can then be renewed as is; the latter change with each transaction, and their impact on fraud prevention may encourage some large issuers to opt for static tokens. Various related authentication mechanisms also are complicating token standard development.

Meanwhile, the focus on card brands, payment firms and associations, and mobile companies and merchants has drawn attention away from shoppers and what will encourage or discourage them from using tokens, especially for mobile payments. “If the consumer links multiple wallets or solutions, and the tokenization schemes are not connected or interoperable, what will happen?” the report asks. “How should differences between non-interoperable and fully updated systems be explained to the customer to avoid confusion or frustration?” The study also considers other ways businesses have used payment card numbers, and tokens' potential impact on these initiatives.

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From "The Fed Wants to Clean Up Token Confusion"
Pymnts.com (09/29/14)

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The Pros ands Cons of Digital Currencies

There are many unaddressed issues surrounding the benefits and drawbacks of digital currencies, and it is vital to know that such currencies are used as a means of exchange without third-party support. The benefits include lower transaction costs and anytime payment capability, while the pitfalls include risks concerning security, payment beneficiary identification, and currency volatility. Still, large and prestigious companies in such industries as online retailing and food and beverage are eager to broaden the use of digital currencies, and their success in such initiatives may give these currencies entry into the mainstream payments ecosystem.

Among the factors companies should consider is that the digital currency user base is still relatively small, while the regulatory framework and tax treatments of digital currencies are being worked out. Moreover, the infrastructure for supporting wider use of digital currencies is a work in progress. Areas where digital currency use may benefit companies significantly include reduction or elimination of currency exposure risks for businesses engaged in foreign countries, through their use as a transport currency. Another potential advantage is disintermediation, process streamlining, and removal of infrastructure costs because digital currencies circumvent both clearing houses and banks, enabling direct transactions between payors and payees.

Although nominal transaction processing fees may be levied, net fees are significantly lower than traditional channels. The catch is that settlement risk may be heightened because digital currency operates outside of a carefully regulated and tested interbank payments system. Digital currency use also may require companies to build and maintain parallel processes and infrastructure mechanisms to collect, focus, and disburse funds. On the other hand, the advent of digital currencies may benefit legacy banking infrastructure, products, and services as big transaction processing banks may have no choice but to innovate, boosting and simplifying connectivity in existing banking systems in response to this new and disruptive technology.

From "The Pros ands Cons of Digital Currencies"
TMI Magazine (10/14) No. 227, P. 31 Frank, Peter; Lopes, Bruno; Taplinger, Adam

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Current Payments News

Report Says Treasury Function Is Changing

Corporate structures, reporting, technological systems, oversight, and control are all struggling to keep up with the evolving function of treasury, according to a new PricewaterhouseCoopers (PwC) report. The report examines ways in which treasurers have started to play a more vital role in business operations since the financial crisis. The research indicates a need to move away from treasury as a distinct department, instead treating it as a function or strategic approach that feeds into all parts of an organization. The report's conclusion may result in a shift toward greater focus on key performance indicators, which only a minority of companies currently apply to treasury reporting. Big data challenges also are affecting treasury reporting capabilities, requiring better data integration across enterprise resource planning, treasury management systems, and banking in real time, according to the PwC report. "The direct crisis management actions that treasurers took in the first few years after the crisis have now been replaced by a focus on sustainable solutions that integrate with systems and processes across the organization," says PwC's Sebastian di Paola. "Today, we see a corporate treasury profession that's maturing and consolidating its role as the custodian of financial and liquidity risk management."

From "The Changing Face of Treasury"
Treasury Insider (10/20/14) Kennedy, Lindsey

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Consumers Increasingly Blame Companies for Data Breaches

Consumers are quick to blame companies for data breaches that compromise their personal information, according to a new HyTrust poll. The survey found 51 percent of 2,000 respondents will take their business elsewhere after such a breach, while about 46 percent said companies involved in breaches should be held "criminally negligent" the moment a breach occurs, with responsibility for intrusions delegated to all company officers. Meanwhile, just 12 percent withhold judgment until the company suffers another breach. Moreover, consumers in a higher income bracket tend to wait before condemning a company, while blame is more vehemently targeted on a compromised company when a person's identity is stolen or misused. The survey also found 60.2 percent of customers in the key 35- to 44-year-old demographic said they are more likely to switch businesses in the event of a breach. Male and female respondents aged 25 to 34 years old tend to view companies' chief security officers as those most accountable for a breach. "What this poll shows is that companies are finally, and inevitably, being held to account for their security vulnerabilities," says HyTrust president Eric Chiu.

From "Consumers Increasingly Blame Companies for Data Breaches"
Help Net Security (09/25/14)

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Report Predicts Soaring Growth in Non-Cash Transactions

Non-cash payments volumes will increase nearly 10 percent to 366 billion transactions in 2013 thanks to strong growth in developing markets and mobile payments, according to the 10th annual World Payments Report from Capgemini and Royal Bank of Scotland (RBS). The report says developing nations comprise more than 50 percent of worldwide non-cash payment growth, while RBS' William Higgins says China could emerge as the leading non-cash payment market within five years if it maintains its current population and growth rates. Still, the report says the U.S. and the Eurozone lead in terms of non-cash payments per resident, with Finland ranking highest by this measure with 448 transactions per person per year. Capgemini and RBS observe a convergence of electronic and mobile payments thanks to growing use of tablets and smartphones, creating challenges for payments services providers (PSPs). They predict m-payments will grow 60.8 percent in 2015 while e-payments growth will slow 15.9 percent annually as mobile payments ramp up. The report found this trend is pressing PSPs to update their payments processing infrastructures, whose ideal foundation is a single integrated payments platform for corporate and retail payments and a central nexus.

From "Payments Industry Challenged by Soaring Growth in Non-Cash Transactions"
Finextra (09/30/14)

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Payments Industry Focus Turns to Fraud, Security

The payments industry is refocusing from mobile payments and Bitcoin to fraud and security, according to discussions at the Tomorrow's Transactions Unconference. Industry experts such as Dave Birch say mobile devices can be used to improve payments security via their location and device ID capabilities. Apple, for example, is concentrating on embedding security within its Apple Pay mobile wallet, announcing tokenization and Touch ID biometrics. Despite the attention lavished on Apple Pay's NFC capabilities, many expect in-app payments to be an area of greater focus, which could threaten the business of both card issuers and terminal makers. Apps also promise to counter fraudsters' use of card-skimming devices to steal data and produce counterfeit cards, which experts say offers much more security than having consumers use the same PIN for every transaction. Data was another key topic at the Unconference, with many advocating consumers' ownership of their own information and noting millennials' migration to apps that can follow specific brands to help realize this goal.

From "Payment Industry's Focus Turns to Fraud, Security"
PaymentsSource (09/23/14) Reutzel, Bailey

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Reduced ACH Return Rate Threshold Coming

Voting members of NACHA have approved a NACHA Operating Rule amendment to cut the unauthorized automated clearing house debit return rate threshold from 1 percent to 0.5 percent starting Sept. 18, 2015. An originating depository financial institution will be subject to possible reporting and fines if they have an originator or third-party sender whose return rate for unauthorized debits go beyond the existing threshold. According to NACHA, the 0.5 percent threshold is more than 16-fold higher than the average network return rate of 0.03 percent for unauthorized debit entries in 2013, which emphasizes the importance of institutions focusing on high return rates and working with their customers to bring any excessive rates down. The amendment also creates a review process for when returns for administrative or overall return reasons exceed certain levels; this will be 3 percent for administrative returns and 15 percent for overall returns. Administrative returns include debits returned for such reasons as closed account, invalid account number structure, and account number not corresponding to an existing account. Overall returns for ACH debits include unauthorized and administrative reasons, such as insufficient funds and stop payments.

From "New ACH Return Rate Threshold on the Horizon"
Portals and Rails (09/22/14) Shaw, Deborah

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Debit Interchange to Remain Unchanged Following Fed Survey

The Federal Reserve Board announced that its interchange cap on large debit issuers will continue as is for the present, in spite of findings that some of their significant costs either fell or were unchanged from levels estimated by an earlier survey. "The Board does not plan to propose revisions to the...interchange fee standard or the fraud-prevention adjustment based on these survey data," the Fed says. The survey found that 64 percent of covered issuers had average authorization, clearing, and settlement (ACS) expenses, including issuer fraud losses, below 21 cents plus 5 basis points of the value of a transaction last year. The Fed says this represents a slight decline, in comparison to the 66 percent of covered issuers with average ACS costs under the maximum interchange fee in 2011. However, the National Retail Federation cites the survey's finding that 99 percent of debit card issuers continue to process more interchange than recommended by the Durbin Amendment. The Fed survey also estimates fraud losses to all parties to debit and general-use prepaid card transactions totaled $1.57 billion in 2013. Meanwhile, average fraud losses as a share of transaction value increased slightly from 7.8 basis points to 8.0 basis points.

From "The Fed Will Leave Its Debit Card Interchange Cap Unchanged for Now"
DigitalTransactions.net (09/18/14) Daly, Jim

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Debit Card Regulation Benefiting Big Merchants

The Durbin Amendment to the Dodd-Frank financial reform legislation of 2010, which capped fees banks can charge merchants to process debit card transactions, has not worked out the way Congress intended. Instead of benefiting consumers, an estimated $1 billion to $3 billion annually have been transferred from poor households to large retailers and their shareholders because banks have attempted to compensate from the lost interchange revenue through higher charges for other things, such as monthly fees for having a debit card or even an existing account. In 2009, banks provided 76 percent of current U.S. accounts free of charge, but in 2013 that figure was only 38 percent. The higher charges have pushed 1 million Americans out of the formal financial system. A paper by the International Center for Law and Economics estimates the Durbin Amendment has cost banks $6.6 billion to $8 billion annually, while retailers appear to have gained the bulk of the windfall. The European Commission is seeking to reduce interchange fees for credit and debit cards to a low, uniform level throughout the European Union, and the Reserve Bank of Australia already has mandated a cut, from 0.95 percent to 0.55 percent.

From "Regulating Debit Cards: Plastic Stochastic"
Economist (10/04/14)

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