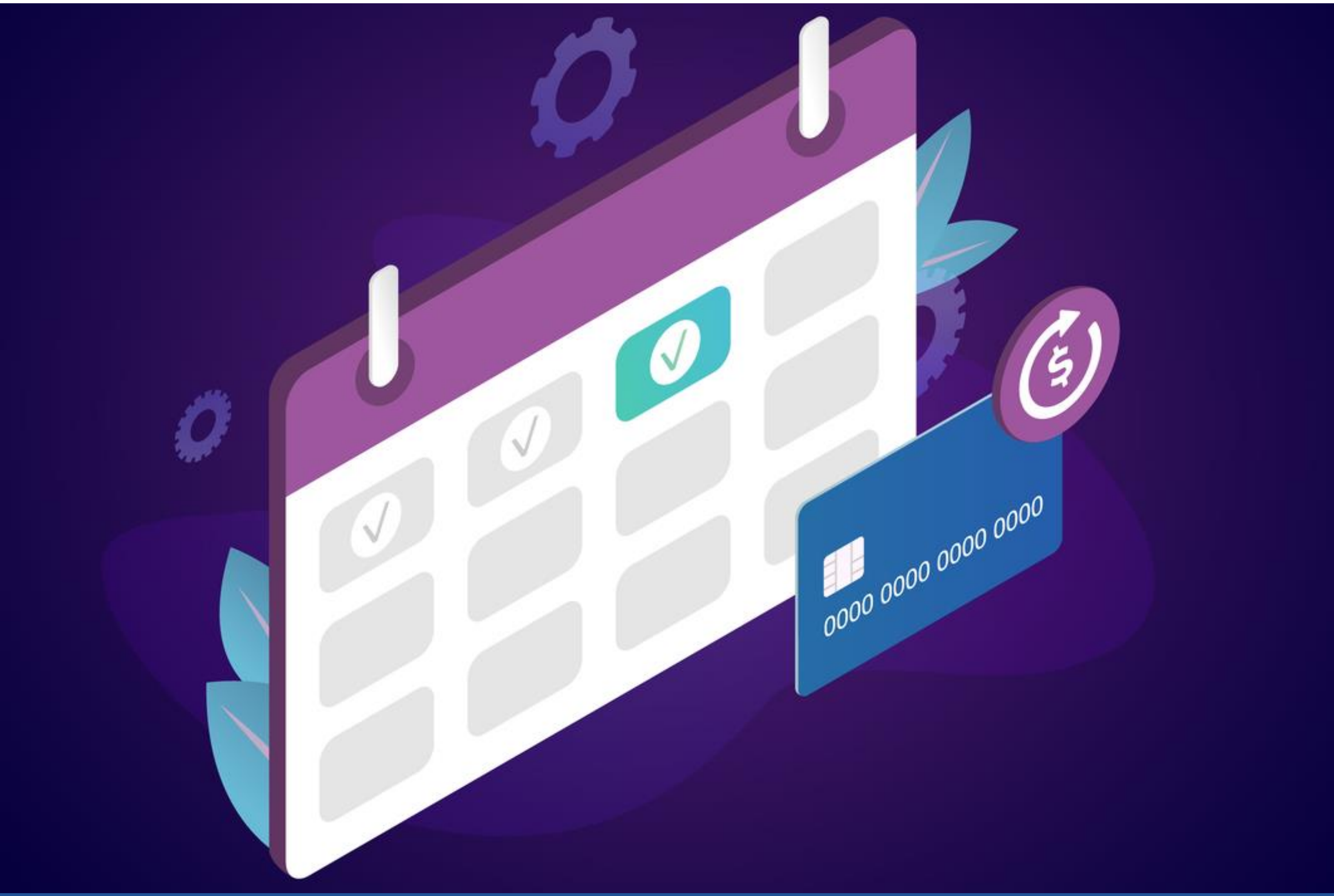

Beneficial Characteristics of Real-Time Recurring Payments

Fasterpaymentscouncil.org

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INTRODUCTION

This Beneficial Characteristics paper provides a foundation for conversation about the specific characteristics required in a recurring payment program that maximize the benefits of faster, real-time payments for payers, payees, and all participants in the payments ecosystem.

A recurring payment, also known as a standing order, is an instruction or set of instructions a financial institution account holder gives to their financial institution to pay a set amount[1] at regular intervals to another's account. These instructions permit the retail financial institution to respond on behalf of the account holder to the request of a retailer, merchant, or biller ("the payee") that is seeking to receive funds for goods or services from a financial institution account on a regularly scheduled basis. The financial institution account holder ("the payer") controls the standing order and sets the start date, end date, authorized payment range, and frequency of the payment.

The scope of this effort addresses the beneficial characteristics of a real-time payment as a payment option specifically for the billions of recurring payments that happen in the United States. The real-time payment option, by design, ameliorates many shortcomings associated with recurring payments by supporting a faster and more convenient customer experience for the user and by simplifying merchant back-end processing.

- Real-time recurring payments have both the benefits of real-time payments - being instant, final, and irrevocable - as well as the customer benefits of frictionless recurring payments. Given the rapid growth in subscription services over the past few years, the need for real-time recurring payments has become essential to allow for various industry verticals to expand into real-time payments. In addition, customer expectations for instant payments have emerged as a byproduct of their need for immediate access to goods and services.
- Today, most recurring payments take days to settle. Real-time payments use a "good funds" model thereby eliminating merchant back-office processing headaches related to return items or non-sufficient funds (NSF).

The beneficial characteristics highlighted in this document are titled "Core Characteristics," meaning that they are deemed to be fundamental to support real-time recurring payments. For purposes of this discussion, there are five core characteristics:

- Notifications
- Authorization
- Authentication
- Payment
- Irrevocability

Although some of these beneficial characteristics may be present already in real-time payments, the focus of this evaluation is on the nuances as they relate to the recurring nature of these payments and the attributes that are unique to the acceptance of these payments in real-time.

REAL-TIME RECURRING PAYMENTS - CORE CHARACTERISTICS

1. Notifications

Description

Notifications provide status updates on setup, modifications, and payment to participants in the payment ecosystem to ensure clear communication of payment processing expectations. Recipients of these notifications include consumers, retail, and commercial financial institutions (FIs), payment networks, and billers.

Notifications for real-time recurring payments are important to both business entities (payees) and consumers (payers). While a variety of recurring payment notifications can be supported, the most beneficial are standing order setup notifications and payment status notifications made on a standing order (e.g., paid or unpaid). Management of standing orders is supported via dashboard and associated notifications. Communication of notifications is delivered through the customer's preferred channel (e.g., application, SMS/MMS text messages, email, or dashboard).

Although a core characteristic in nature, notifications may be optional at discretion of the payee or their service provider.

What are the Benefits?

Notifications provide a better experience, enabling increased control and security over the setup process and use of recurring payments. Without notifications, the process of resolving discrepancies in standing orders can be exasperating for merchants. For example, a "failure to pay" can take upwards of 30 days to resolve, thereby requiring the payee to chase down the customer to set up another payment. Notifications can reduce that elapsed time.

Who Benefits?

<u>Payers (Consumers)</u>

Consumers benefit from the transparency that notifications provide because they provide the customer with pertinent insight, allowing them to manage their finances more effectively. Providing status and confirmation for each step is a natural progression in the recurring payment process that builds consumer trust and confidence.

<u>Payees (Retail and Commercial Financial Institutions[2])</u>

Retail FIs, commercial FIs, payment networks, and other third parties can benefit by delivering value-added functionality to end users. Notifications enhance the customer's experience, which is particularly important for real-time payments, and can help build customer confidence in setting up other real-time recurring payments. Notifications can also aid in reducing fraudulent transactions and eliminating processing cutoff times.

Payees (Merchants)

Notifications enable merchants to manage their accounts receivable more effectively.

Why are these Benefits Important?

With real-time payments, the funds are transferred immediately upon payment, so it is important for the payers and payees to have confidence that the recurring payment is set up properly and made in accordance with the standing order instructions. Notifications provide transparency about the status of standing orders for all participants in the ecosystem.

The following section titled "Notification Details" provides a deeper dive on the types of notifications beneficial to payers and payees for real-time recurring payments.

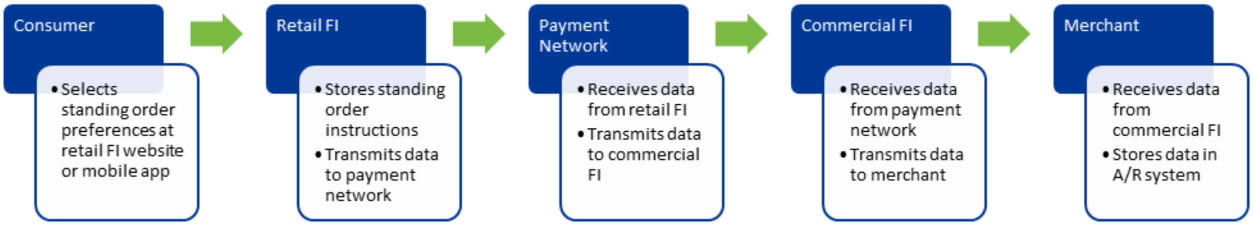
Notifications Details

The sections below provide detail about the types of notifications that can be enabled with real-time recurring payments – specifically for setup, management, and payment of standing orders. We explored two main variables below: 1) whether the consumer sets up a standing order at a retail FI or at the merchant's website and 2) whether the data is transmitted via a payment network or a third party. This is not an exhaustive list.

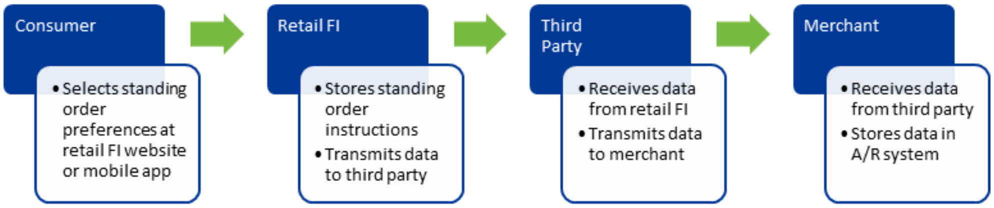
Standing Order Setup

We will explore four different models for collecting standing order preferences from consumers. This includes the initial setup of the standing order along with any subsequent changes made by the consumer. Each of these models are outlined separately below.

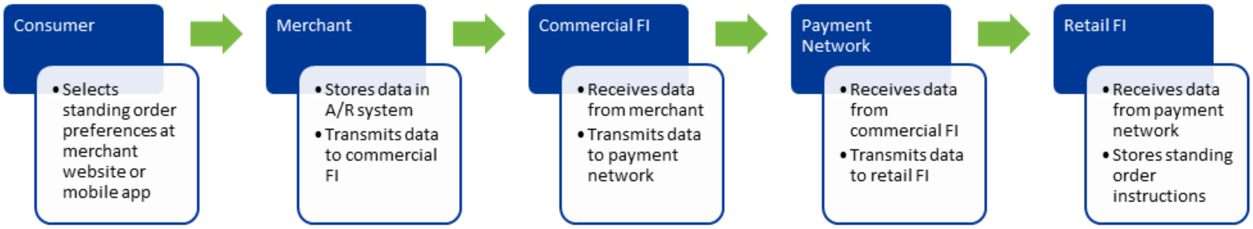
1) Setup occurs at retail FI with payment network transmitting standing order data.



2) Setup occurs at retail FI with third party transmitting standing order data.

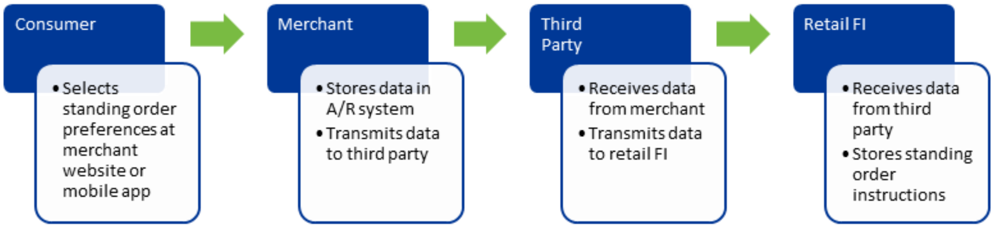


3) Setup occurs at merchant with payment network transmitting standing order data.



The retail FI would send a message back to the merchant confirming that the standing order was successfully stored. This would flow in the opposite direction of the arrows above, going from retail FI -> payment network -> commercial FI -> merchant.

4) Setup occurs at merchant with third party transmitting standing order data.

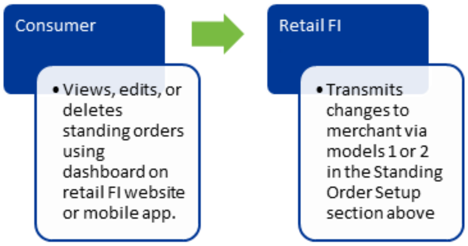


The retail FI would send a message back to the merchant confirming that the standing order was successfully stored. This would flow in the opposite direction of the arrows above, going from retail FI -> third party -> merchant.

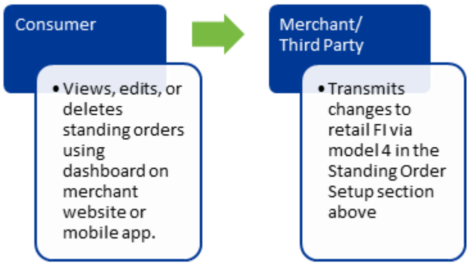
Standing Order Management

Consumers could have a central dashboard from which to view, edit, or delete standing orders with multiple merchants. We will explore two different models for offering this dashboard, which are outlined below (this is not an exhaustive list).

1) Dashboard accessed at retail FI website.



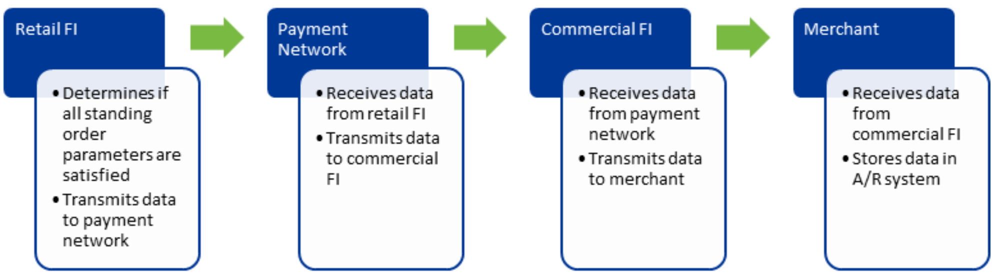
2) Dashboard accessed at merchant website using third party service.



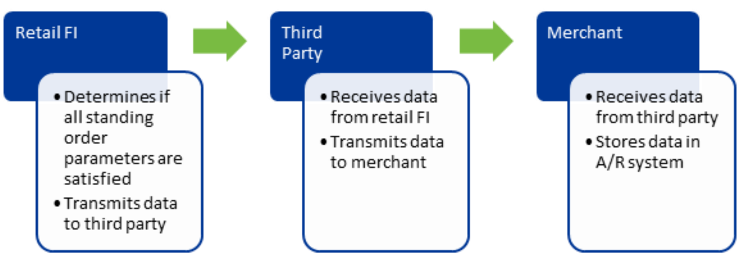
Standing Order Payment

It is valuable for merchants to know if a standing order is paid (or not, along with the reason). This information will come from the retail FI. We will explore two different models for transmitting this data, which are outlined below (this is not an exhaustive list).

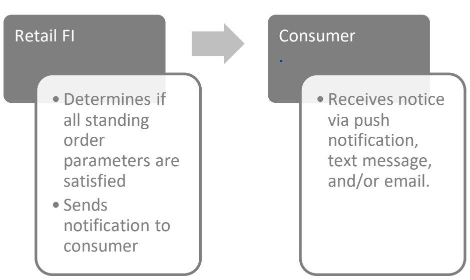
1) Retail FI notifies merchant that standing order is paid (or not). Payment network transmits data.



2) Retail FI notifies merchant that standing order is paid (or not). Third party transmits data.



Optional: Retail FI notifies consumer that standing order is paid (or not).



2. Authorization

Description

Customer authorization is a critical component in the setup process of a recurring payment, as it captures the customer's consent to the standing order. Authorization must provide the customer with the ability to set payment parameters that will be validated by their financial institution prior to payment initiation.

Authorization occurs within the customer's preferred channel. Key authorization parameters are payment type, dollar amount range or threshold, payment timing, payment frequency and authorization duration. Customers should be able to view, change, and cancel their authorization easily. Explicit terms and conditions must be available for review and acknowledgment by the customer prior to finalizing the authorization. The customer's financial institution must capture and store authorization details.

What are the Benefits?

Authorizations ensure the customer's instructions are captured and followed, minimizing customer confusion and frustration, and providing the customer with control.

Who benefits?

<u>Payers (Consumers)</u>

Authorizations help mitigate negative customer experiences and puts the customer in control of when and whether requests are paid according to their chosen parameters. Customers can independently modify payment parameters and/or cancel standing orders thereby reducing customer apprehension about preauthorized payments.

Once authorization is provided, the payment initiation becomes automated, meaning the customer does not need to take action or authorize each payment.

<u>Payees (Billers)</u>

The authorization process increases the likelihood that customers will adopt recurring payments due to the increased control and security, resulting in billers receiving timely, irrevocable recurring payments.

<u>Payees (Financial Institutions)</u>

Authorizations reduce risks and costs to financial institutions from unauthorized payments and dispute resolution.

Why are these Benefits Important?

To encourage adoption, customers need to have certainty around recurring payments to their billers. Financial institutions also need the security of having their customer's approval to make payments in the manner that they are directed.

3. Authentication

Description

Authentication is the process by which a party verifies the identity of the payer to ensure that they are who they say they are. Authentication is typically done by a third-party provider or the payer's financial institution and may involve practices such as multi-factor authentication (MFA). MFA typically requires paying parties to fulfill at least two factors from several categories, such as knowledge (PIN or password), possession (a device such as smart phone, tablet, computer, etc.), or something inherent about the person (such as thumbprint, facial scan, iris scan, etc.). MFA takes place prior to payment message submission, preventing account takeover whereby fraudsters pretend to be someone they are not. MFA may also be performed when changes are made to the standing order.

While MFA can significantly reduce the incidences of fraud, most authentication measures do increase transaction friction. If not handled properly, this can lead to increases in cart abandonment or making payments via another payment method. Financial institutions may ask their third-party provider to support an authentication process that limits friction so that the customer experience is not adversely affected.

The success of a real-time recurring payment method also entails conducting security and risk assessments when authenticating the payer, which could include behavioral analysis done by the payer's financial institution or payment service provider.

From the payer side, authentication tools such as confirmation-of-payee (CoP) can ensure that the entity receiving the funds is the actual organization or individual that the payer is trying to reach.[3] Approved Push Payment (APP) fraud occurs when a fraudster pretends to be a biller or individual and sends requests for payment to individuals pretending to be a biller. As implemented in various countries, CoP alerts the payer if the individual to whom they are trying to send money is not the person they say they are.

What are the Benefits?

Authentication ensures the customer's identity is verified, reducing fraud, and increasing trust in the process.

Who Benefits?

<u>Payers (Consumers)</u>

Payer authentication has several benefits for all parties involved in the transaction (payer, the payer's payment service provider, and the payee)—namely a reduction in the likelihood of fraud taking place.

This strengthens customer confidence in the safety of the transaction, which can lead to increased purchases from that merchant.

<u>Payees (Merchants)</u>

From the merchant perspective, authentication increases the merchant's trust that there will not be any issues related to misdirected payments (i.e., a consumer thinks they paid the bill, but the payment went to a fraudster and any potential reputational damage to being the victim of fraud attacks.

Payees (Financial Institutions)

From the financial institution's perspective, authentication supports risk mitigation, which limits financial loss and potential reputational damage. Additionally, it allows improved service offerings for clients.

Why are these Benefits Important?

Fraud has the potential to adversely impact all parties involved, as it increases costs to merchants and to financial institutions, and indirectly to consumers – if not directly, in those situations where the consumer has been defrauded. Lowering the risk of fraud using multi-factor authentication is beneficial to all stakeholders.

4. Payment

Description

A real-time recurring payment is a payment that is set up in advance to occur at a certain interval either for a set number of times or until cancelled. A typical use case would be paying a subscription fee for a service or product.

As the merchant requests a payment, a response code (either approval or rejection with the reason for such rejection) will be provided to the merchant. If a recurring transaction is authorized, the expectation on settlement/pay-out is that the funds from the customer will be transferred on a real-time basis, and the funds will also be paid to the merchant in real-time. In other words, if the transaction has been authorized, the transaction will be settled instantly. This would be applicable to any recurring transaction.

What are the Benefits?

The major payment benefits for real-time recurring payments include:

- Proximity to the funding source (e.g., access to cash-flow)
- Greater transparency in the form of predictable payment cycles between consumers and the merchant
- Higher customer retention
- Remaining top-of-wallet
- Cost savings/cost avoidance in the form of reduced or reallocated overhead (e.g., call centers)

Who Benefits?

Payers (Consumers)

Consumers have more control with recurring real-time payments, as the standing order is clearly presented and easily modified. Specifically, the payment will only be generated if it is within the parameters defined in the standing order ensuring the funds transfer will be handled appropriately and the consumer will not be unexpectedly charged.

There is also less friction. Consumers can quickly and securely sign up for a recurring payment. Moreover, as the payment occurs on a real-time basis, the consumer can access purchased goods/services instantaneously.

Recurring payments also provide consumers with more transparency, as they gain a clearer picture of the payment process.

Payees (Merchants)

The payment process provides merchants with access to funds on a real-time basis for recurring transactions.

If a transaction is rejected, the merchant has transparency into the reason for the rejection and can remediate the payment failure or assist the customer with correcting the error, depending on the source of the failure. For example, if a customer's account is in suboptimal standing, the merchant can either reach out to the customer to intervene and fix the payments failure (e.g., add funds to his/her financial institution account), or the merchant could retry the transaction in the case of non-sufficient funds (NSFs), whereby the customer does not need to intervene.

It is expected that merchants will experience higher customer retention with recurring payments. Improving the customer experience can potentially result in reduced overhead costs.

Payees (Financial Institutions)

Payment-rich capabilities are attractive features and provide an opportunity for acquiring new customers. Recurring transactions are an appealing option because they have a higher likelihood of authorization as compared to cards. Declines associated with outdated payment credentials or fraud are less likely to happen in a faster payments environment.

Financial institutions can experience cost savings in reduced overhead cost by improving the customer's experience.

Why are these Benefits Important?

Recurring payments create greater control, security, and stickiness with the customer. This increases digital payment volumes, reduces fraud, and builds trust, thereby fostering longer-term relationships. These benefits can also decrease the likelihood that customers will revert to prior payment or billing preferences. More predictable payment cycles benefit billers, merchants, and financial institutions alike.

5. Irrevocability

Description

Irrevocability is a core feature of real-time payments that is agreed upon by all network participants. Once a real-time payment is authorized, it is a final and irrevocable. Unlike other payments that allow payments to be "clawed back" by the payer through dispute and return processes, real-time payments only provide the opportunity for a payer to request that a payee return the payment. The payee is not obligated to return the funds.

This characteristic of real-time payments drives value for all participants. It also places a premium on payer authentication and real-time transaction screening to minimize unwanted payments from being initiated on the network.

What are the Benefits?

Irrevocability enables real-time payments to operate in a good funds, final payment environment. This enables payee (e.g., corporate, retailer, biller) business models to operate without the traditional overhead expenses related to managing disputes and returns.

Irrevocability also creates the opportunity for new business models based on an environment without the limitations associated with managing for the potential of disputes and returns. This enables payees to release goods and services immediately upon payment and improve margin/lower costs due to the elimination of chargeback losses.

Who Benefits?

<u>Payers (Consumers, Corporates)</u>

Irrevocability benefits payers by offering them payment finality. This improves their financial control, provides immediate confirmation of payment receipt, simplifies reconciliation and account management, and eliminates their likelihood of overdrawing their accounts. Payers also benefit by receiving immediate access to purchased goods and services.

<u>Payees (Corporates, Retailers, Billers)</u>

Irrevocability benefits corporates, retailers, and billers by enabling them to execute their business models, assuring they have received good funds from the payer. This enables them to credit a payee's account and release goods or services immediately upon payment receipt. Due to irrevocability, payees also see improved cash flow, simplified liquidity management, decreased fraud, and reduced back-off expenses related to monitoring and managing disputes and returns.

<u>Payees (Retail and Commercial FIs)</u>

Irrevocability benefits financial institutions by creating a streamlined payment experience for them and their customers. This offers the opportunity to reduce operational expenses associated with complex dispute and return management processes as well as the ability to develop new solutions based on final payment for payables and receivables.

Why are these Benefits Important?

Payment finality (irrevocability) improves existing payment models and creates opportunities for new solutions to improve the lives of consumers and merchants. Chargeback expense reduction lowers the costs of providing goods and services creating price reduction/margin maximization opportunities. Elimination of disputes simplifies the payment experience for all participants where, depending on situations, dispute management takes time to resolve, and corresponding charge back expenses could result in higher costs than what the actual ‘service’ was valued at or provide an unfavorable customer experience.

CONCLUSION

This paper is the output of the U.S. Faster Payments Council, Real-Time Recurring Work Group, which represents a variety of backgrounds including financial institutions, card brands, fintech, other financial institutions, and merchants. We are most grateful for their input, as their unique perspective is essential in creating the full picture of real-time recurring payments. However, this is just the starting point. Continued collaboration between industries is needed to create tools, educate users, and on-board institutions.

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- Maria Arminio (FPC Work Group Facilitator), Avenue B Consulting

Notifications contributors:

- Nick Denning, ICBA Bancard
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- Kevin Tholke, Mastercard

Authorization contributors:

- Lisa Akahoshi, Visa
- Ashley Czajkowski, BNY Mellon

Authentication contributors:

- Ross McFerrin, Trustly
- Andrew Gómez, Lipis Advisors

Payment contributors:

- Alexandra Lara, Netflix
- Moa Agrell, Trustly

Irrevocability:

- Jan Watson, Fifth Third Bank
- Dean Nolan, Fifth Third Bank
- Denis Bouchard, FIS Global

Overall contributors:

- David True, PayGility Advisors
- Jill Tschappler, The Central Trust Bank
- Arlene Vogel, The Central Trust Bank
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- Steven Leitman, Visa

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1. Note: In some cases, the dollar amount and/or interval can be variable.
2. Note: Retail Financial Institutions are consumer facing. Commercial Financial Institutions support merchant and business customers.
3. PYMNTS.com. (2021, December 1). *Confirmation of Payee (CoP) Offering Makes 'Massive Difference' for UK Businesses Tackling Fraud*. https://www.pymnts.com/news/security-and-risk/2021/cop-offering-makes-massive-difference-for-uk-businesses-tackling-fraud/