Seizing the opportunity; understanding the reality

Capitalising on the growth of instant B2B payments

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Across all channels, client segments and geographies, payments are getting faster – even if not always quite real time, nor quickly enough to keep up with the momentum of demand. Pace is now paramount both in domestic payment infrastructures, serving largely retail and small business customers, and international networks, meeting the more complex needs of institutional and corporate clients. The speed of progress varies, with some markets and institutions still stuck in the slow lane. But the direction of travel is clear, notwithstanding the differing priorities of retail and wholesale customers. In this report, Chris Hall and Mike O'Hara of Inbound Realization look at the challenges and opportunities associated with the growth of instant B2B payments, with ***Mark Bradbury*** *of Apply Financial, Mike Walters of Form3, Ebury's* ***Toby Young, Brad van Leeuwen*** *of Railsbank, and industry commentator and author* ***Chris Skinner.***

Introduction

Whether satisfied with same-day or requiring real-time, customers will no longer accept payments that lag delivery of goods and services, or fail to exploit the opportunities for efficiency and transparency yielded by digital technologies.

"The adoption of real-time payment systems around the globe has contributed to an environment in which many consumers, merchants, and financial institutions expect to be able to pay friends and customers, settle bills, and transfer money at the drop of a hat," says **Mark Bradbury**, founder and managing director of Apply Financial. "Even for traditional payment types, consumers have generally come to expect faster settlement periods, notifications and consolidated reporting."

The trajectory of the UK's Faster Payments, one of the earliest national instant payment schemes, illustrates the gathering velocity of demand and the scope for exponential future growth. Having processed 3,000 payments an hour in May 2008, its first month of operation, Faster Payments was processing 230,000 payments an hour ten years later. Overall, Faster Payments surpassed two billion payments in 2018 (a 23% annual rise). Independent research commissioned by the organisation predicts 3.3 billion payments by 2020. Past growth has been driven largely by consumer demand (not least due to the scheme's initial lower value limits), but future uptake will be much broader based. A white paper issued in May 2018 cited new business models, technologies and functionality as key future demand drivers, with the B2B market increasingly influential, alongside C2C and B2C use cases.

All around the world

In the decade since Faster Payments' inception, similar initiatives have emerged with increasing frequency. Two schemes have been launched in Europe recently, with EBA Clearing's RT1 service and the Eurosystem's TIPS (Target Instant Payment System) both offering instant euro payments, the latter using central bank funds. Australia's New Payments Platform went live in February 2018, with around 70 participating institutions, whilst similar initiatives are gaining critical mass in Thailand, Singapore and Hong Kong. Canada and the United States, on the other hand, are lagging.

Many experts predict that new schemes will replicate the UK path, with momentum building gradually at first, before growing more rapidly. "Penetration in Europe isn't quite there yet. SEPA Instant's €15,000 cap will restrict the possibilities, but those limits increase over time. Banks will be surprised with uptake," says **Brad van Leeuwen,** head of partnerships at open banking and compliance platform Railsbank.

Chinese 'super-apps' are delivering fast efficient payments to consumers, but the local authorities' willingness to support integrated financial and commercial systems is unlikely to be replicated in the western hemisphere. Chinese smart-phone payment services utilize VR codes, and providers such as AliPay have struck deals with European peers to enable Chinese tourists to make holiday purchases with the wallets they use at home. AliPay's QR code is becoming the standard for instant cross-border retail payments, with Finland's ePassi enabling Finns to make smartphone-based payments in Norway via a deal with Den Norske Bank's Vipps. "QR could be the main form of retail payment within the next five years," says financial markets commentator and author **Chris Skinner.**

Meanwhile, a revamp of the global correspondent banking network is accelerating cross-border payment speeds for wholesale clients. Historically, reciprocal deals between correspondent banks have left corporates in the dark for days, if not weeks. But SWIFT gpi – a new initiative by the financial message network provider to track payments between correspondents – is now reducing payment times to a matter of minutes, which is typically sufficient to satisfy a client base focused as much on certainty and transparency, as speed.

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>
> **Chris Skinner,** financial markets commentator and author

"There is growing demand for real-time payments capabilities between institutions," says Skinner. Acknowledging interest in blockchain-based alternatives such as Ripple, Skinner notes that SWIFT, as a bank-owned cooperative, can only move as fast as its membership. And slow-moving banks are not the only barrier to faster wholesale payments. "No matter how much the bank innovates, the corporate client is often not ready to incorporate those innovations," he observes.

Broader business demand

Nevertheless, **Mike Walters**, chief product officer at payments solutions developer Form3, believes B2B use cases for instant payments will accelerate as value limits rise. Scheme limits vary, but Faster Payments is reported to have trialled payments in the tens of millions of sterling, well above its current £250,000 cap. "But we're already seeing the emergence of business models that make greater use of smaller transaction sizes, which inevitably increases demand for instant payments," says Walters, citing a more widespread use of microfinance. Rather than a big loan, firms are taking out sequences of smaller transaction-based loans, meaning principal sums and early repayment need to be much more immediate.

Similarly, insurance firms are using instant payments to deliver rapid pay-outs to policy-holders in the event of an emergency need, with the simplicity of instant 'push' payments rapidly replacing cards across retail financial services. Growth of usage-based subscription models for vehicle hire or entertainment access are also driving demand, as instant payments are more easily reconcilable than credit card payments.

Toby Young, chief technology officer at Ebury, an FX and payment services fintech provider, also predicts growing interest from firms that would like to lock in FX rates via instant payments to support cross-border transaction flows. "Deliverable FX, particularly where same day delivery is required for the buy side currency to a beneficiary on the other side of the world, is sensitive to cut-off times for both trade and payment. If we execute on behalf of a customer, we will need to receive funds before those cut-off times to ensure settlement today. Instant payments adds significant flexibility to our operations and massively improves the service we can offer", he explains.

For van Leeuwen, the intersection of instant payments and open banking is providing opportunities for innovation. "You can introduce new intermediaries into the transaction flow to add new value," he says, noting the services of firms such as Wagestream, which offer interest-free, instant payday lending, through real-time payments. "They can inject themselves between the salary disbursement by the employer and the receipt of salary, without disadvantaging the employee, which changes the risk profile."

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Further, payment service providers (PSPs) are also now able to offer account services that overlay existing bank accounts to provide greater visibility and control over cashflows. These services have a symbiotic relationship with instant payments, which makes them both increasingly attractive to SMEs and even larger firms. Control and visibility of cashflows are critical priorities in the corporate treasury departments of large corporates. As such, instant payments are becoming more interesting to larger firms through the development of request-to-pay functionality, which enables firms to offer incentives for early invoice settlement.

Safety at speed

The potential of instant payments is undoubtedly exciting. But the reality is more prosaic, with the way ahead strewn with familiar obstacles. In short, the supporting infrastructure is not yet sufficiently well-built out to deliver on the ambition of innovative service providers. There is limited interoperability between national schemes, whilst both domestic and cross-border mechanisms are hamstrung by the legacy-laden capabilities of incumbent banks. This means the internationally recognised standards and open source technologies struggle to achieve the interoperability they were designed to deliver. For instant payments to realise its potential, much remains to be done, by the industry collaboratively and by individual service providers.

"Faster Payments can be very quick, taking just hundreds of milliseconds between sending and receiving for a good number of banks. Some larger banks with older technology may receive the payment message from the scheme fractions of seconds, but there are constraints on how long these banks take to process it and reflect it to the customer account," explains van Leeuwen.

One substantial challenge is the fundamental need to make payments both fast and safe. Whilst technology innovation is enabling greater speed, flexibility and convenience for payment users, it has also increased the vulnerability of payment systems to 'bad actors'. Swathes of legislation have been introduced to thwart parties with criminal aims, from terrorist financiers, to organised criminals to opportunist hackers. Banks and other payment service providers have invested significant resources to comply with rules and regulations to prevent fraud, money laundering, market abuse and related activities.

Much effort has been directed at resolving the tension between the payment speeds expected by clients and the safety demanded by regulators, governments and law enforcement agencies. Payment validation and other AML / KYC compliance requirements, such as sanction screening, are now integral to payment processes. But the workflows that support the safe movement of money between accounts must be upgraded and streamlined continually in the era of instant payments.

"The faster the payment, the more important validation becomes. Most traditional European payment systems operate a two-day settlement cycle, but with an instant payment, when you hit 'send', it's gone," says Bradbury. Validation and related services will become more important as B2B use of instant payments continues to build. "Corporates are interested in more detail around a payment so they know what it relates to, plus any charges, along with accurate validation of the beneficiary to make sure it gets to the correct account. For both retail and wholesale markets, the ultimate goal of regulators is to provide certainty and in particular Confirmation of Payee (CoP)," adds Bradbury.

Pay UK, the umbrella body for UK retail payments infrastructures including Faster Payments, outlined plans in October 2018 for its Confirmation of Payee service, designed to reduce the risk of payments being sent to the wrong account. At present, the account name is not checked when an electronic payment is sent, which allows fraudsters to trick people into sending to a bogus account. Under the scheme, which is being rolled out this year, the intended recipient's bank will inform the payment initiator if the wrong name for the account holder has been entered, but will not prevent the payment.

"Reducing fraudulent or errant payments requires the regulators and banks to work together to get consumers to accept terms of engagement that allow account information service providers to validate their name as well as the account details," says Bradbury, adding that similar initiatives are under consideration in Europe and the US.

Internal and external affairs

Tools that fixed broken payments with a T+2 settlement cycle will struggle to be effective when payments are settled in a matter of seconds. Although banks with slow back-ends can add minutes to instant payment processing times, at the other end of the spectrum, more tech-savvy rivals are looking to allow just 50 milliseconds for compliance and validation processes for their instant payments services. Often this is in recognition of the need to allow ultra-fast API-based access by multiple third parties to their payments infrastructures.

Overall, however, the necessary supporting infrastructure has not been upgraded sufficiently, leaving customers dissatisfied and incumbents vulnerable. Response times to payment errors are a prime example. Bradbury points out that the ability of service providers such as Apply Financial to resolve a payment validation query, for example, is dependent on the provision of data by other parties. "The source of the bank data in the UK – the Extended Industry Sort Code Directory – has no service level agreements in place, so can only advise us to call up the bank in question when problems arise. This industry is running before we walk in terms of providing services around faster payments," he asserts.

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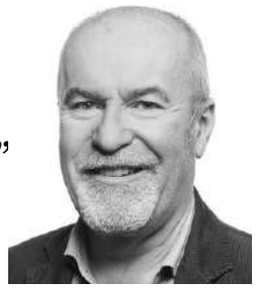

The technology is available to address these challenges, paving the way for seamless data and transaction flows in a real-time environment. But the required investment has not necessarily been made at the payment infrastructure or individual service provider level. Interoperability between instant payment schemes, for example, is a complex issue, but not an intractable one.

At one level, interoperability requires use of common standards. Globally, most recent market infrastructure renewal schemes have been built using the ISO 20022 message framework, but UK Faster Payments was not. Pay UK's planned National Payment Architecture – "the biggest change to the way payments are processed in the UK since the 1960s" according to chief executive Paul Horlock – will use the standard but will not be ready until 2021 at the earliest, thus potentially impacting UK interoperability until then.

Young expects and welcomes wider use of ISO 20022, but suggests it's only part of the interoperability picture. "You will see some standardisation for instant payments, but there will still be different local reason codes and regulations across jurisdictions. Further, countries have different risk appetites, and different ways of policing their rules. The key focus needs to be systems like LEIs to aid in understanding of the parties involved in the end to end flow."

Noting Mastercard's acquisition of real-time payment systems provider VocaLink, as well as other nascent efforts to provide bridges between domestic real-time schemes, Railsbank's van Leeuwen says the journey toward a single global real-time payments network has begun, albeit still in its very early stages. "The challenges around making cross-border payments real time are not to do with data, but the money, i.e. settlement etc., thus the systems are a little bit more complex," he admits.

Opening up

But to deliver instant payments effectively, change also needs to come from within the industry, both in terms of mindset and underlying technology. Specifically, the opportunity to interact quickly and efficiently with clients, counterparties and collaborative third-parties is not yet being fully grasped by incumbent banks. "There is no technical reason why instant payments market infrastructures are not API ready, but most are not, mainly because most banks don't speak to infrastructures using APIs," says Walters.

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> **Mike Walters,** chief product officer, Form3

In many cases, instant payments has been accompanied by the rapid evolution of open banking, the growth of which has been advanced by both regulatory initiatives and competitive forces. In Europe, it is synonymous with the second Payment Services Directive (PSD2), which obliges banks to share account and transaction data with third-party service providers via open APIs, if directed by users, to spur competition. But the scope of open banking is much broader, encompassing the development of new services and business models driven by use of collaborative technologies, including, but not limited to, APIs.

Over time, the constituent elements of a payment – or any other commoditised financial service can be broken down, re-aggregated across and delivered by multiple specialist providers on a plug-and-play basis, rather than being supplied by one generalist. The benefit to the end-user should be improved service levels through innovation and competition, plus new value propositions, emerging through easier collaboration between providers.

Form3's Walters expects open banking to drive demand for instant payments higher, because of the light it can shine on retail and wholesale customers' cash flows across multiple accounts. "In an open banking environment, where you can see and access balances in third-party accounts, you don't want to wait an hour to be able to action it," says Walters. "Open banking will change customers' behaviour and that will cause more organisations to move more volume more quickly. If you have a real-time information flow running in parallel to a real-time payment infrastructure, then the use cases get super-interesting."

Ebury's Young argues that the combination of open banking and instant payments has the potential to disrupt card payments, notwithstanding the established norms and practices in domestic retail markets. "Fundamentally, open banking, done right, will give people a feeling of security to make instant payments directly from their bank, not via a card. Instead of typing in my card details, I'll log onto my online banking and make an instant payment. Merchants will receive money direct from the bank, not wait on a five-day settlement from the credit card clearer."

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Toby Young, chief technology officer, Ebury

But Skinner argues that regulatory intervention might be required to force the pace of change. "Open APIs haven't transformed European financial services and payments yet because the banks are resisting. With open banking, banks are making it way too difficult for customers to use it, for example the permission structures they put in place to try and stop customers giving data to third parties," he says.

Faster in future

As the forecasts from Faster Payments suggest, the instant payments market is still very much in its early stages, with future growth driven by a number of powerful factors, including demographics and the pace of digital technology innovation in the fourth industrial revolution. These will drive the expansion of use cases, but the payments sector must adapt quickly to take advantage of impending exponential demand growth.

According to Form3's Walters, the combination of open banking and instant payments infrastructures will deliver the rich, real-time information flows between multiple parties, laying the basis for a whole generation of new service propositions. "But many hard yards must be travelled first. "Most organisations move money in real time, but not all. Only with consistency will people rely on them," he warns.

Apply's Bradbury not only sees more domestic markets delivering real-time payments platforms, but changes in the underlying banking infrastructure aimed at building a global framework for faster payments. For example, the Bank of England is known to be looking at synchronisation between central banks globally to enable instant payment exchange and eliminate settlement risk. "With more countries implementing instant payment schemes, the next one to five years will see a big percentage of the world accepting this as the norm," says Bradbury. "The opportunity is there."

For van Leeuwen at Railsbank, real-time payments are just a very important part of a larger puzzle, challenging service providers to collaborate and aggregate to serve retail and wholesale customers more effectively. He sums up, "We should be shooting for a great customer experience, but the ability to send a payment instantly is only one leg. You still need fantastic onboarding, transaction monitoring and strong compliance, whilst still delivering a good experience for the customer. Various companies help with different parts of the user journey, and you need these to work together."