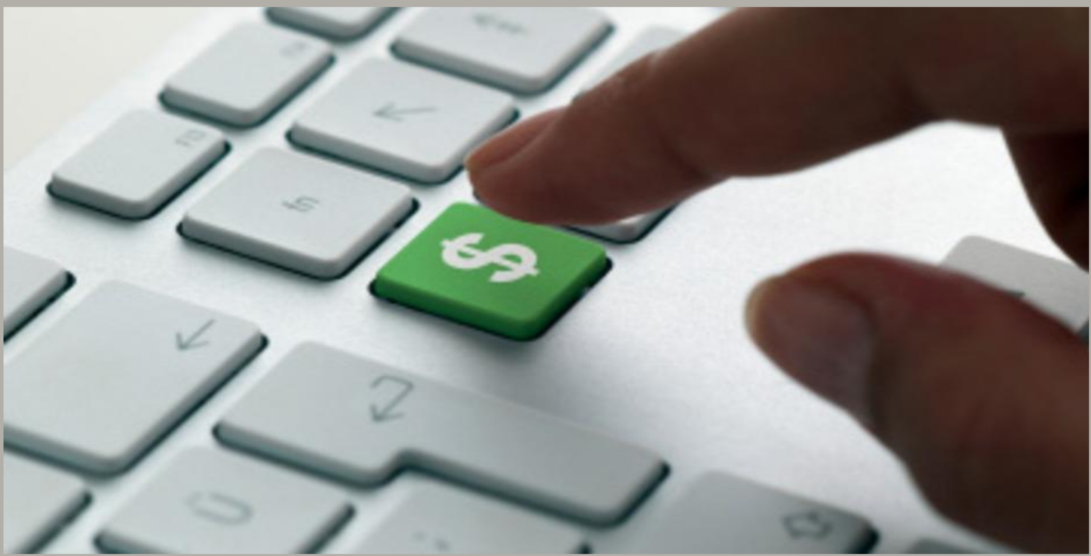
INSIGHT

INSTANT PAYMENTS

A CLARIFICATION OF THE VISION, THE BENEFITS AND IMPLICATIONS OF THE NEW CASHLESS CASH.



In an on-demand environment where both digital communication and commerce grow in importance, expectations of new available payment solutions that offer the same experience as cash, start to rise. Since these solutions (should) result in the immediate interbank clearing and crediting of the payee's account, this "new" payment method can be referred to as cashless cash; a money transfer as direct as a cash payment. Due to improved technologic advances and ongoing regulatory pressure, the awareness of and demand for instant payments is expected to increase further in the future and could potentially harm the existence of cash. It is therefore the question if and how financial institutions should participate in this journey of cashless cash in order not to lose out on new innovative players entering the market.

Background

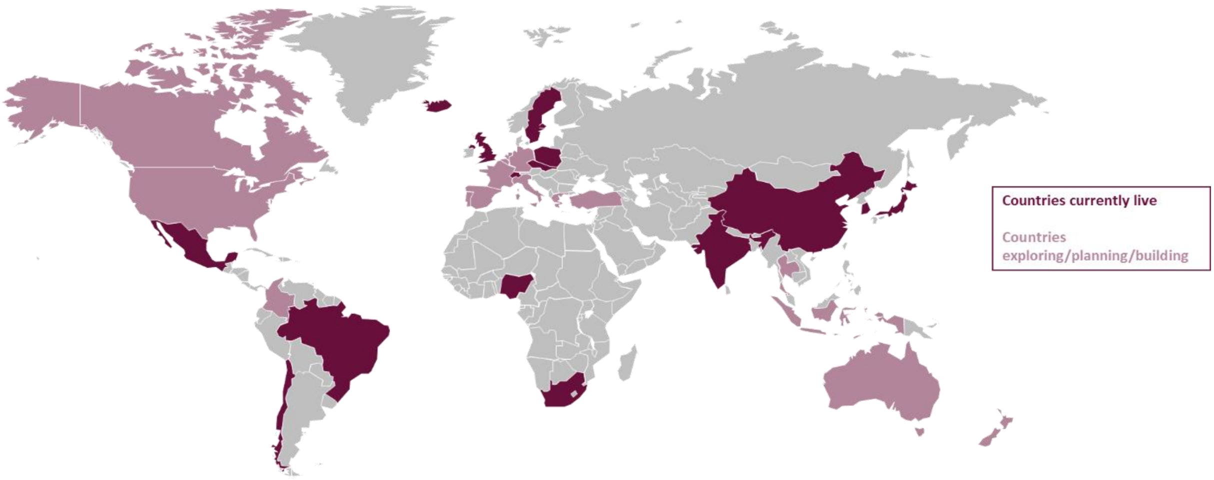
Our environment is currently characterized by digitalization, leading to a booming e-retail commerce and an increased use of smart devices. Research has shown that both e-commerce as well as mobile payments are increasing very fast, with mobile payments growing at a pace of 16% per year[1], and are also expected to keep on growing in the future. Furthermore, the technologic progress from the last couple of years has resulted in improvements in the physical supply chain, with players such as Amazon and eBay going for a (less than) one day delivery. The financial supply chain, in contrast, keeps lagging behind. However, consumers now expect their funds to move as fast as their goods, since they are now able to use their mobile devices to access m-commerce services all around the clock. In order to meet the new expectations and to respond to the appetite for real-time information, initiatives regarding the implementation of instant payments solutions offered by banks and non-banks are going global.

At the moment, as shown in the figure below, at least 13 countries are currently live or in development with their (near) Instant Payment Scheme with six of them been developed in the last three years[2]. Examples include the Faster Payment Service in the UK, the FAST scheme in Singapore, BiR in Sweden, SPEI in Mexico and IMPS in India. The Faster Payments Service in the UK grew at a compound annual growth rate of 34.6% between 2009 and 2013.

Definition of the new Cashless Cash

Instant payments are defined by the ERPB as "electronic retail payment solutions available 24/7/365 and resulting in the immediate or close to immediate interbank clearing of the transaction and crediting of the payee's account (within seconds of payment initiation), irrespective of the underlying payment instrument used (credit transfer, direct debit or payment card, electronic money) and of the underlying clearing and

Core Features of Instant Payments
• 24/7 Availability • Instant Delivery • Immediate Confirmation • Account-to-Account transfer • Digital Processing • Irrevocability

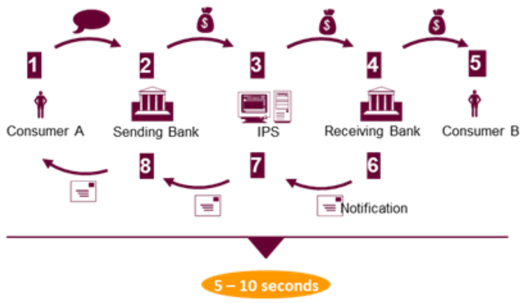


[1] In China, the transaction volume of mobile payments even grew by 170% in 2014 as a result of the increased penetration of mobile devices in smaller towns and cities.

[2] These numbers can differ dependent on the definition used. Here, Instant Payment schemes and similar are illustrated.

settlement arrangements that make this possible."

The given figure 2 illustrates the main steps in the flow of an Instant Payment. Initially, a bank customer (being the payer) gives the instruction to the sending bank to transfer an amount of money to the payee. This bank performs a corresponding funding and security check, after which the transaction is submitted to the Instant Payment Service. The transaction is then submitted to the receiving bank when all the necessary information is available. The receiving bank authorizes the payment, confirms the receipt and credits the account. Finally, all parties are informed about the completion of the transaction. Whereas the clearing and settlement of the high volume, low-value transactions are normally batched, netted and processed on a deferred net settlement basis, this process now only requires 5 to 10 seconds. Instant payments can therefore be referred to as cashless cash; a money transfer as direct as a cash payment.



Main drivers of the growth

Financial institutions should keep a close eye on the evolution of instant payments as its penetration is expected to rise in the future. This increase is driven by 5 main forces; New entrants, Technology Innovation, Expectations, Regulation and Globalization.

New Entrants. New players, both banks and non-banks, are entering the payment sector rapidly, offering new products and services to the market and in turn increasing competition with incumbents. Social media platforms, digital currencies and Tech companies such as Google and Facebook, look for ways to correspond to the increased mobile and e-commerce penetration by offering accelerated payment methods to their customers. These players often do not have to comply with the more stringent financial regulations, fostering an easier way to market new products and services.

Technology Innovation. As a result of technological improvements and the corresponding fall in the cost of technology, instant payments are becoming more realistic. The introduction of virtual currencies and the Blockchain technology for example, can further facilitate the use of instant payments in the future. For further reading about virtual currencies, **click here.**

Expectations. Thanks to the introduction of smartphones, cloud computing and in general the internet, information is available to consumers on a real-time basis. This has led to the fact that consumers also expect their payments to keep up at the same pace. In addition, merchants look for ways to improve their cash flow management and liquidity position. This could potentially improve their customer service in the future.

Regulation. All around the world, regulatory bodies are making efforts to stimulate fast payments[3]. Services that offer greater end-user protection, transparency and reduced credit risk are favored. Although different initiatives arise with a lot of similarities, the reasons for regulatory bodies to support them can differ across the regions[4]. The adoption rate appears to be the strongest where regulatory bodies play a leading role and collaborate with financial institutions who are committed to the initiative[5].

Globalization. As stated above, a growing number of countries are currently employing instant payments Schemes and so, are putting pressure on other countries to follow their lead. In addition to this implementation trend, more and more of the commerce happens across country boundaries thanks to globalization. This in turn has fostered the demand of faster international payments. The speed of these payments will be dependent on the amount of banks implementing an Instant Payment Scheme that is able to interact on an international level.

[3] For example, the introduction of UK PSR and European PSD II has fostered competition and innovation in the payment landscape which in turn stimulates the growth in instant payments. For further reading about PSD II, **click here**.

[4] For example, the aim of their efforts can be to improve the velocity of money through the national economy. In India and Nigeria, IP schemes are implemented to extend financial services to the unbanked or underbanked while in Japan and the UK they are implemented to foster competition in the payment sector.

[5] For example, in Mexico, a strong support of the regulatory bodies has contributed to the fast adoption of the SPEI scheme.

Instant Payments offer benefits to each stakeholder.

Instant payments can offer benefits to different stakeholders of the payment environment and should be considered when assessing the attractiveness of the new scheme. Stakeholders involved are the public authorities/regulators and society, merchants and corporations, consumers and financial institutions.

Public authorities and society. Instant payments offer the possibility to accelerate the business cycle. This in turn will increase the velocity of money and hence, feed economic growth. In addition, thanks to a modernized payment system, the e-commerce and physical point-of-sale are facilitated and a country may attract more foreign investments, stimulating the economy even more. As a result of a reduced use of cash and an improved information flow, instant payments can serve as a potential solution for the so called black economy, creating a more formal one. Consequently, governments can possibly benefit from an increase in tax receipts.

Merchants and corporations. For merchants and corporations, instant payments can serve as an accelerator of the business cycle, smoothening the cash flow and helping them to better manage the day-to-day operations as liquidity is improved. In addition, thanks to the aforementioned improvement, the dependency of the companies on external financing can potentially decrease. Payments system modernization can also be a catalyst for an improved B2B e-invoicing solution, decreasing operational costs[6].

Consumers. Thanks to the introduction of instant payments, consumers will be able to make payments outside of banking hours on an instant manner, improving their experience regarding e- and m-commerce. As consumers will use cash less, there will also potentially be less opportunistic robbery and crime. Since these systems will be supervised by regulatory bodies, the introduction will induce an improved information flow, giving rise to a safer payment environment.

Financial institutions. Financial institutions can benefit from instant payments in different ways. First of all, new services and products based on the new infrastructure can be offered to the customer. This, together with the fact that banks are able to engage new customer segments such as the underbanked, will stave off future share losses from alternative financial service providers. Financial institutions will be able to use the new products and services to strengthen the relation with its customers. In addition, as previously mentioned, less cash will be used, reducing costs related to cash management[7]. For example, less ATMs will be needed to serve the customer. The fact that a lot of payments will both originate and be received electronically, will improve the information flow, help to reduce the ambiguity around the hidden payment environment and reduce the average end-to-end costs of payment transactions.

The introduction of Instant Payments does not come without issues.

Notwithstanding the fact that public authorities will continue to push these initiatives to financial institutions, the aforementioned benefits should be weighed against the additional challenges this new payment scheme imposes.

First of all, the initiative will be very costly since there is a considerable initial investment needed from each party involved. This could potentially form a barrier for smaller players to participate. In addition, operating costs will increase due to a need for better liquidity management, better and faster risk management, appropriate resources to guarantee 24/7/365 and costs related to testing[8]. Not only the costs related to the initiative but also the additional risks are of a concern. As transactions are completed in a matter of seconds and are not recoverable, additional AML, fraud avoidance and compliance measures should be put in place. In order to guarantee a suitable scheme and to avoid fragmentation, stakeholders[9] have to collaborate, both within and across countries. No single bank can create a scalable payment scheme on its own. Differences in regulations, standards

[6] Converting invoices from paper to electronic yields a cost savings of up to about 70% per invoice.

[7] Research performed by Sia Partners showed that the cost related to cash amounts to €300 million in Belgium.

[8] The total costs, being the total investment plus the ongoing costs, for the Faster Payment Service in the UK amounted to 800 million GBP over a seven year period.

[9] This includes but is not limited to regulatory bodies, banks, telecommunication companies, infrastructure providers, and PSPs.

and requirement make this however a challenging topic. This is especially a concern in the SEPA zone since fragmentation would undo work performed as part of the SEPA migration. Additional costs will arise if banks have to comply with a fragmented payment landscape without interoperability.

Lastly, important decisions have to be taken regarding the messaging standards, the participation model, clearing and settlement mechanisms, and the governance.

How are the EU and its financial institutions planning to be participants of this journey?

The pace of development and usage is increasing in Europe, with instant payments clearly becoming a key strategic topic nowadays. In a survey of the ERPB, 45% of the participants is convinced instant payments will trigger a next innovation wave in Europe. In June 2015, the EBA Clearing launched a blue print of a Pan-European Instant Payment Scheme which they are planning to introduce in the SEPA zone. With the formation of a task force composed of more than 20 representatives of EBA clearing service users, the EU hopes to start piloting in 2017 in order to respond to the increased risk of fragmentation due to national initiatives in different EU countries. The last couple of years, different initiatives have arisen within the SEPA zone, with the Netherlands being the youngest participant. These regulators, however, could generate additional benefits by collaborating on a Pan-European Instant Payment Scheme to develop a set of harmonized standards across the area, a key aspect that is also being highlighted in the blueprint. Banks in turn would benefit as well since they could operate more efficiently, both on a national as well as on an international level.

In addition, the EPC has published its first guidelines and requirements for a Pan-European Scheme in November. These requirements focus on performance rather than clearing & settlement, which is expected to be determined by the participants themselves. Important to note is that this scheme should start from the expectations and requirements from both the demand and supply side in order to increase its potential. In addition, communication and reconciliations standards should be unified in a workable standard to facilitate collaboration across national boundaries. Different countries like Brazil, Poland, Sweden, Singapore, Denmark, Australia, and Japan have already adopted ISO20022, a globally accepted standard. It would be beneficial to review the steps taken by the aforementioned examples to learn from the best practices and accelerate the implementation process. In Belgium for example, the workgroup of Febelfin looks at Sweden as their key example when assessing the attractiveness of an instant payment scheme in Belgium, thanks to their newly introduced clearing mechanism. A go/no go decision for further analysis is expected in the next following weeks.

Conclusion

Instant payments are currently having a transformational effect on the payment environment financial institutions are nowadays active in. As new players will try to disrupt the landscape even more in the future, financial institutions have to look for ways to strengthen their position with value-added services and

Vision of the ECB on the Instant Payment Scheme

- Adopt a **layered approach** to benefit from the harmonization achieved by the SEPA migration.
- The project will consist of a scheme **cooperatively developed** on the market or **multiple interoperable schemes competitively developed** on the market.
- The scheme will be mainly **based on credit transfers**.
- A **multichannel approach** should preferably be used for the interface.
- The **industry will be kept responsible for the technical aspects** but should comply with additional requirements:
  - 24/7/364 availability
  - (Close to) immediate, irrevocably crediting of the payee's account
  - Europe wide reach
  - interoperability

products. Thanks to instant payments, the business cycle becomes shorter, more efficient and less expensive, offering benefits to all stakeholders; consumer, merchant, society and banks. It is however important that all stakeholders collaboratively look for a suitable solution in order to ensure interoperability and efficiency gains. This to avoid fragmentation across the payment landscape. To move forward, financial institutions need to show open-mindedness towards these new technologies in order to fight the competition from players inside and outside the traditional banking environment.

Benefits for different stakeholders			
Public Authorities & Society	**Consumers**	**Merchants & Corporations**	**Financial Institutions**
• Increased competition in the payment sector with more banks and non-banks entering the market • Potential solution for the so called black economy with a likely increase in tax receipts • Boost economy by facilitating e-commerce and physical point-of-sale • Improved information flow. • Tool to spread the use of digital interaction channels between Payments Service Providers in function of Digital Europe • Improved customer experience • Increased velocity of money	• Possibility to make payments outside of banking hours • More convenient to shop on line • More convenient to shop mobile • In-time receipt of money both national and international • Less opportunistic robbery and crime due to less cash • Better user experience • Safer payment environment	• Better cash management • Help to improve liquidity and in turn reduce the need for external financing • Business cycle faster and more efficient • Can be a stimulator for better B2B e-invoicing solutions.	• New services and products for their customers • Ability to serve new customer segments (f.ex: the underbanked segment) • Less cash and in turn lower costs related to cash management (f. ex: less ATMS will be needed to serve the customer) • Improved information flow • Stave off share losses from alternative financial service providers

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