INFORM

Instant payments in Europe: where next?

Foreword

How to make instant payments the new normal in Europe

Payments are evolving significantly – and while there are many areas of development, one of the most significant is that of instant payments. But what's driving the adoption of instant payments, and how is this area progressing in Europe and beyond? This white paper looks at the factors driving the development of instant payments, the possible barriers for adoption and the impact instant payments may have on legacy payment methods.

Section 01:

Speed is of the essence

The world of payments has changed significantly in the last few years, with the demand for immediacy continuing to drive market trends.

Consumers and businesses operate in a world where instantaneous or instant solutions are the expectation, and over 50 countries around the world have now implemented an instant payment scheme. But while the appetite for instant payments continues to grow, different groups have different reasons for focusing on this topic:

01 **Consumers** have a growing expectation that things will happen instantly – for example, people who were previously satisfied if an online delivery took two days to arrive are now looking for same-day delivery. Where payments are concerned, consumers want to know that money has been received immediately.

02 **Corporates** are looking for a quicker view on the finality of payments. The sooner they have that view, the sooner they can complete the reconciliation process. Another consideration is that instant payments represent a good alternative to cards, without an exchange fee mechanism. Meanwhile, the rise of mobile offerings presents a new way to reduce cash and provide alternatives.

03 **Banks** and other regulated financial institutions are being driven by the evolving needs of their customers. If customers are looking for instant payments in today's digital world, that is what banks will need to provide in order to remain relevant.

While instant payment schemes are becoming increasingly widespread, it's also important to understand what actually constitutes an instant payment, and where the opportunities for greater speed actually come from. For example, what happens in between the initiation of a payment by a customer and the receipt of that payment by the beneficiary? And why does processing by the recipient's organisation take time?

In cross-border payments, there is an additional dimension to consider, as the process includes further checks, screening and processing which add to delays. Only by analysing these issues is it possible to understand how the industry can speed up the processing of payments.

> I prefer to use the expression 'faster processing of payments.' Most payments are made electronically, so the instructions and messages move at the speed of light – they can't move any faster. What I feel we should be focusing on is how to speed up the processing of payments and the processing of instructions through the parties in the chain.
>
> **Arthur Cousins**
> Payments Project Coordinator, SADC Banking Association

Section 02:

Obstacles and barriers

While instant payments are continuing to become more prevalent, there are also some significant obstacles where development and adoption are concerned.

For one thing, definitions of market practices can vary significantly. In the UK, for example, the SLA for faster payments is shorter than in Europe – but the SLA is only measured between the sending and receiving bank. In Europe, which has a longer SLA, that SLA is measured from the initiator to the beneficiary.

Another obstacle is that back-office applications are not currently geared up to support the immediate confirmation of payments. While the speed of payment processing is expected to continue increasing over time, the benefits of this will only be realised if the right back-office solutions are in place to support the required speed of processing.

01

Barriers to adoption

Even within the same country, banks may make different decisions about how to offer instant payments.

Some countries currently still see instant payments as an additional service – meaning that they may charge for this service, or only offer it to a certain group of customers. Even within the same country, banks may make different decisions about how to offer instant payments.

Other countries, such as the Netherlands, have approached this differently and decided that instant payments would be enabled for the whole community from the outset, with both larger and smaller banks able to participate. This approach is helped by the fact that domestic payment schemes are not subject to some of the requirements associated with cross-border payments, such as sanctions screening. This approach may be better suited to accelerating the adoption of instant payments.

Additional factors, however, may also represent a barrier to adoption, such as the fact that while inefficient legacy processes have shortcomings, they can also create opportunities for revenue. For example, float can arise in inefficient payment chains, which then earns interest – so if the process becomes more efficient, the opportunities to earn interest on float will be reduced. At the same time, streamlining existing processes takes significant time, effort and money – meaning that the business case for adopting instant payments is not always clear.

> "There's always a demand from the receiver to receive a payment immediately – but that's not always the case for the person who has to make the payment to the beneficiary.

Arthur Cousins
Payments Project Coordinator, SADC Banking Association

02

Overcoming regulatory obstacles

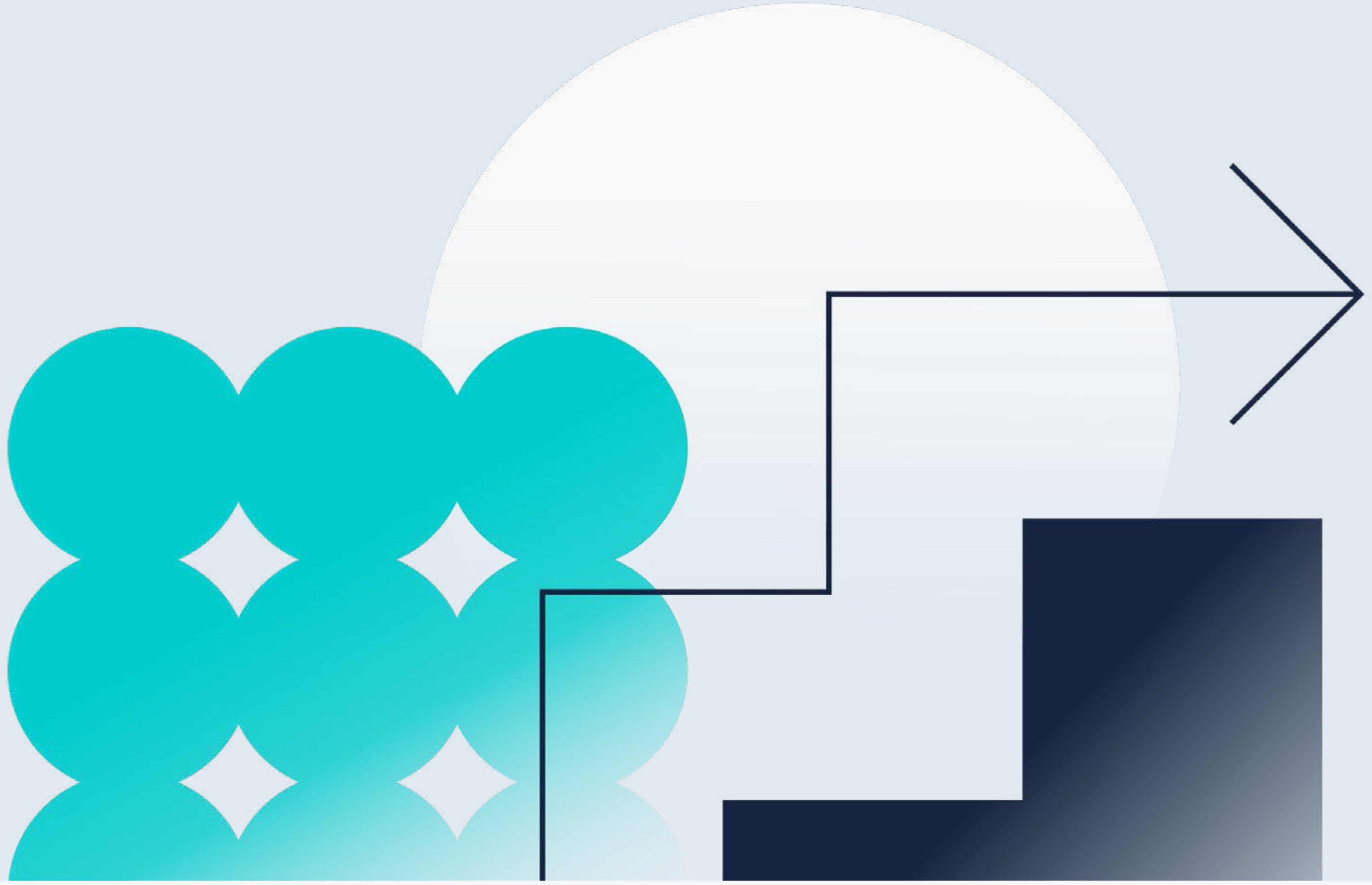
Regulatory barriers are still seen as slowing the uptake of instant payments.

Regulation is, of course, a significant factor when it comes to furthering the development of instant payments. One factor that could significantly accelerate the take-up of instant payments would be to open the market up to financial players that are not credit institutions. Under the Settlement Finality Directive (SFD), only credit institutions are able to hold a settlement account with TARGET2. As such, regulated payment service providers cannot currently become direct members to any Clearing, because they cannot open a TARGET2 account and carry out settlement themselves.

Regulatory barriers therefore need to be overcome in order to increase the uptake of faster payment processing. At present, organisations like the Financial Stability Board and the Bank of International Settlements are actively working to drive improvement. Meanwhile, the European Retail Payments Strategy makes reference to the need for a review of the SFD, albeit without mentioning a specific timeline.

One possible solution in the meantime is for non-credit institutions to use a direct non-settling participation model. Using this model, a non-credit institution is able to take advantage of instant payments by working with a settlement partner which holds a settlement account with TARGET2.

> There are a lot of regulated financial institutions that have high payments volume, that have to adhere to the same kinds of regulations as credit institutions – but are now excluded from participating fully, as direct participation due to the SFD.
>
> **Jolanda Schekermans**
> Head of Product – Europe, Form3



03

Sanctions screening & AML/KYC checks

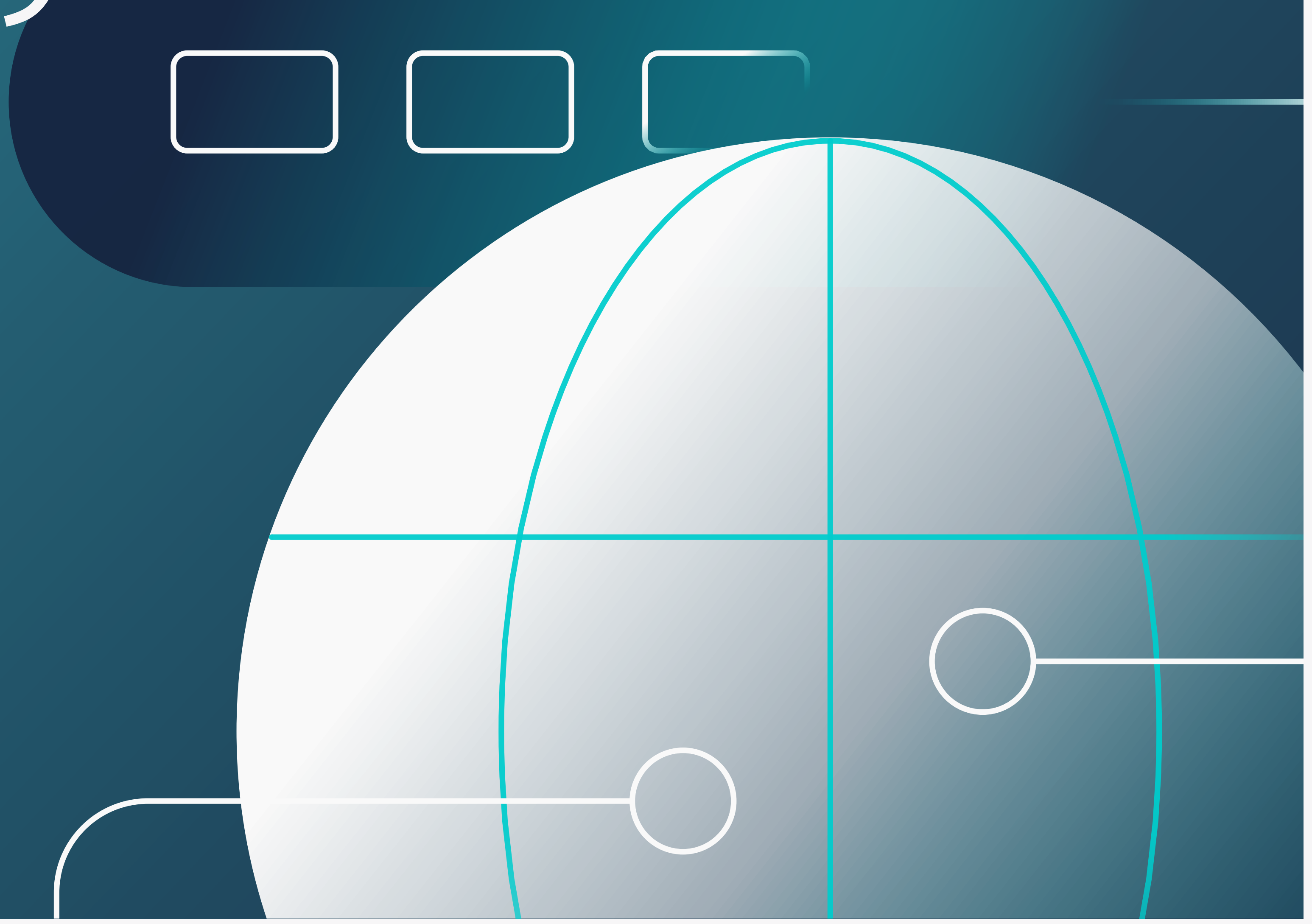
Also significant are the implications of instant payments for banks' back-office processes.

In many cases, the systems used by financial institutions are legacy systems based on batch processing, with regulatory checks carried out on payments in-flight. As such, banks may not be geared up to carry out sanctions screening and AML checks at the speed required in order to de-risk instant payments.

There is considerable opportunity for providers of regulatory compliance systems to use modern technology in order to optimise processes, and indeed the EPC has provided some guidelines on how to do this for instant payments. However, the focus of this guidance is mainly on incoming payments. For cross-border payments, most of the complexity is centred around what the payer is sending and whether the necessary sanctions screening and KYC processes have been completed.

Section 03:

Instant payments in europe and beyond



Instant payments continue to see significant momentum in Europe and the UK.

Europe's instant payment system, SEPA Instant, works with a pre-funded model, meaning that a settlement account needs to hold funds before payments can be made. If funds are not in place, instructions will be rejected.

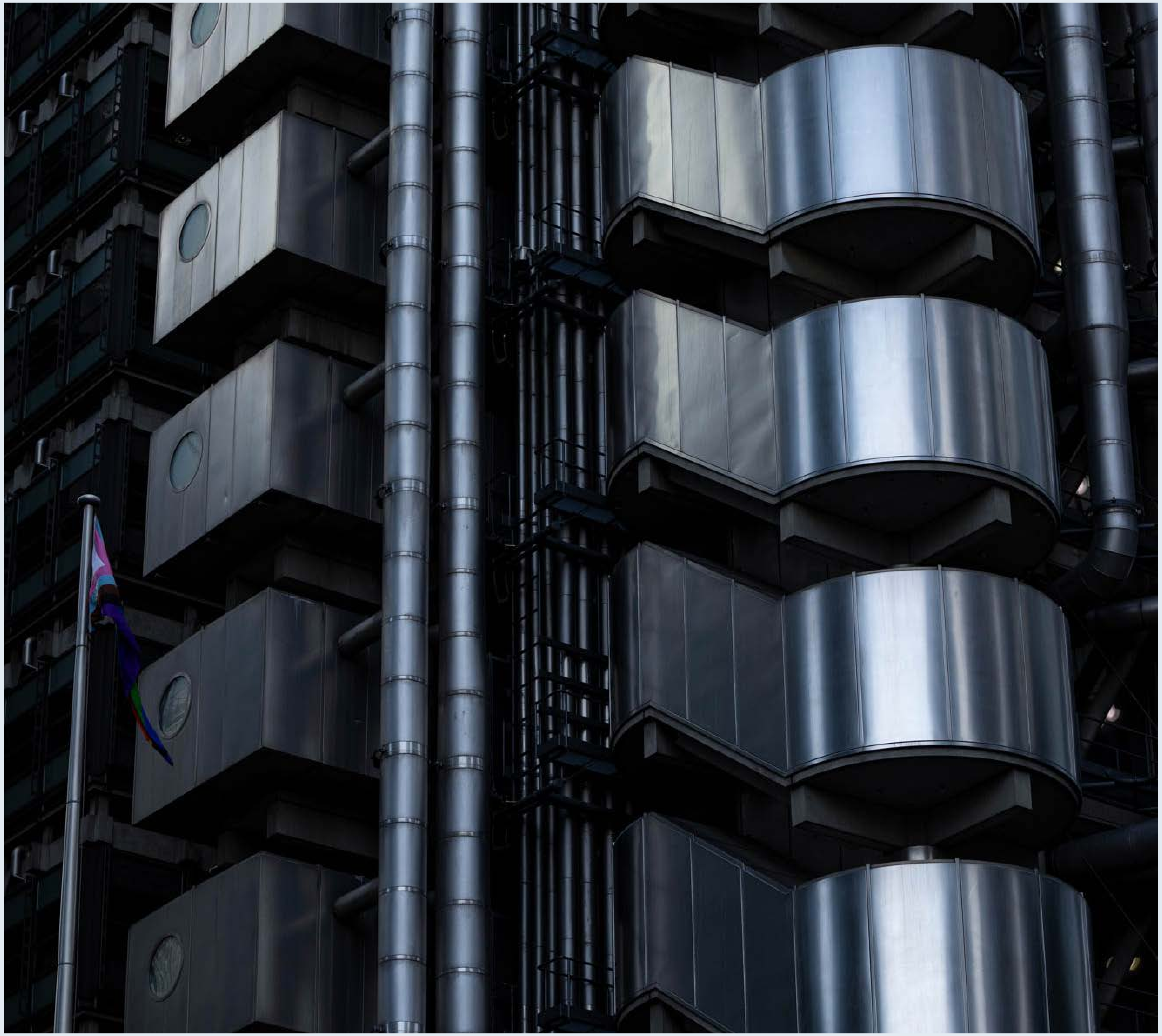
However, when new participants begin using SEPA Instant for the first time, their back-office systems may not necessarily be used to managing liquidity continuously. As such, newcomers to the SEPA Instant scheme tend to over-fund in order to de-risk. And while SEPA Instant is 24/7/365, TARGET2 is not – so people also need to deal with liquidity over the weekends and on holidays. All this requires continuous liquidity management.

The situation continues to evolve

Some regional providers are currently looking into providing a single view on different accounts, in order to provide a better view on where liquidity is and how it can be moved. Some challenges are also set to be eliminated

by the requirement that everyone who is part of the SEPA Instant environment will also need to hold an account with TARGET Instant Payment Settlement (TIPS).

South Africa, meanwhile, has real-time clearing systems for both high value and low value transfers. Most of the countries in the SADC region also have real-time gross settlement systems for high value payments, with little in place for regional payments. At the regional level, there is a high value real-time gross settlement system across the region, as well as an instant clearing of payments infrastructure for retail transactions. Work is also underway to look at linking this infrastructure with schemes in the UK and Europe.



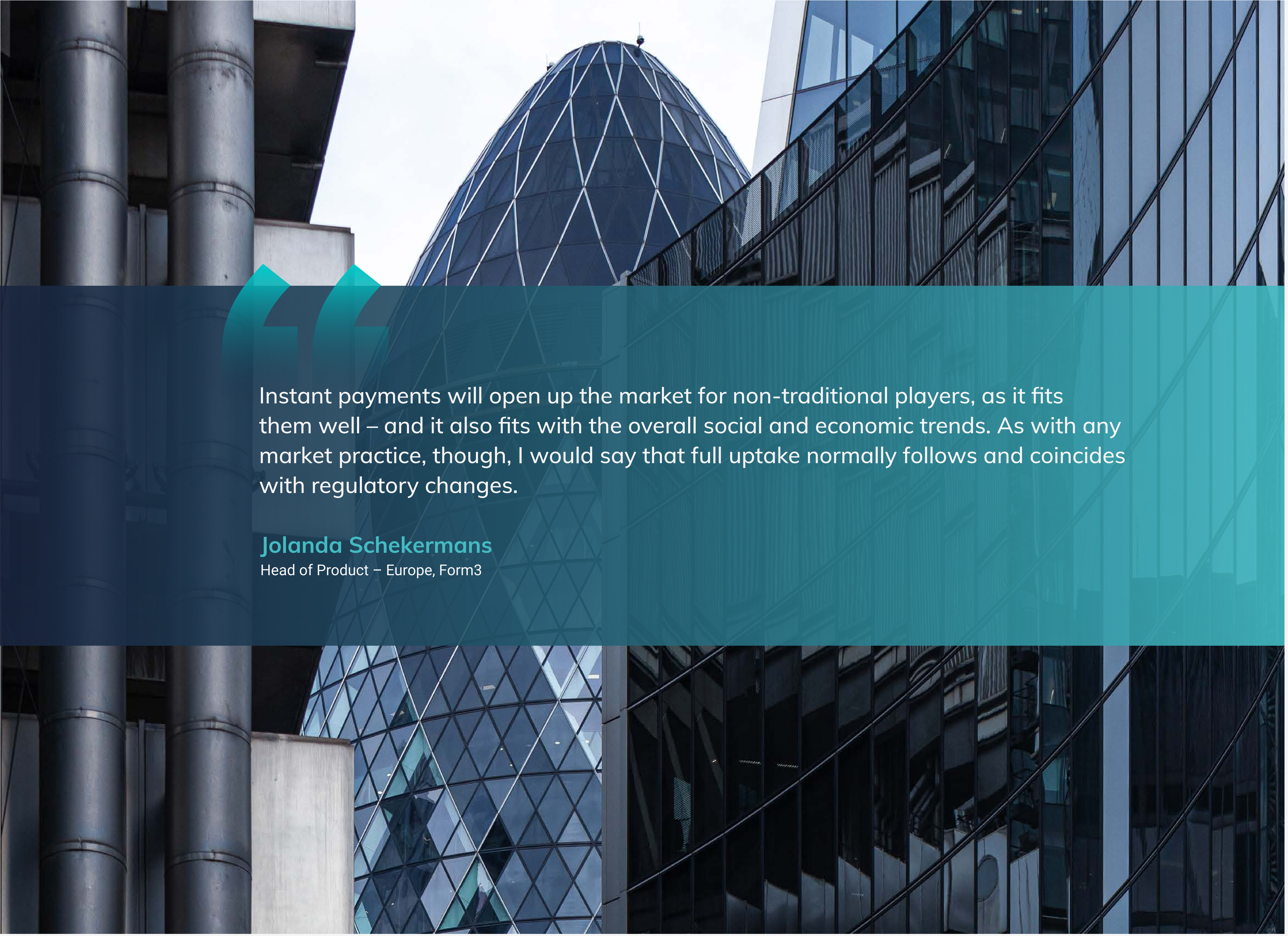
Section 04:

Impact on legacy payment schemes

As the move towards instant payments continues, what does all this mean for legacy payment methods?

While the need for legacy payment methods may reduce as instant payments grow, it is likely that these methods will not become obsolete overnight. The new European Retail Payments Strategy, for example, still caters for solutions for cash and the availability of cash. In addition, reengineering existing payment processing structures such as large corporates' payroll runs and large batch-based government payments would require significant work.

Despite these challenges, it is likely that legacy payment schemes will be modernised in due course, which may means they become closer in nature to instant payment schemes. As shown already for instance the move of STEP2 to continuous gross settlement and the optional CUG that will allow payment submission 24/7.   Importantly, the continuing development of this space will depend not only on the work being done by banks, but on the need for initiating organisations to reengineer their own processes.



> Instant payments will open up the market for non-traditional players, as it fits them well – and it also fits with the overall social and economic trends. As with any market practice, though, I would say that full uptake normally follows and coincides with regulatory changes.
>
> **Jolanda Schekermans**
> Head of Product – Europe, Form3

In conclusion

As the uptake of instant payments continues, there are a number of obstacles that will still need to be overcome, from the constraints of existing back-office applications to regulatory factors. Work is underway to address these issues, and there are solutions which can help to bridge the gap in the meantime. Looking forward, further development could see legacy payment schemes become more similar to instant payment schemes – and both banks and initiating organisations will have a role to play in driving progress in this space.

FORM3

Meet the authors

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About us

Our vision is to be the world’s most trusted provider of payment technology.

We provide Banks and regulated Fintechs across the globe an end-to-end managed payments service that delivers complete payment processing, clearing and settlement to the universe of payment schemes through a single API. Our platform handles everything so you can focus more on serving your customers’ needs and less on managing payments infrastructure.

Contact us →

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