How immediate payments change the game for banks

Lipis Advisors

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Immediate payments are inevitable. There are at least 18 immediate payment systems in operation today, and a growing number of countries and regions are actively planning to enable real-time payments in the coming years. This group includes the United States and Europe, the two largest payments markets in the world. In recent years, payment industry stakeholders have stopped asking if immediate payments are coming and started planning for how they will affect payment habits and payments infrastructures. More importantly, banks, consumers, and businesses will need to be ready for how this will change the game in payments.

AN IMMEDIATE PAYMENT (SOMETIMES REFERRED TO AS A REAL-TIME PAYMENT, INSTANT PAYMENT, OR FASTER PAYMENT) IS AN INTERBANK ACCOUNT-TO-ACCOUNT PAYMENT THAT IS POSTED TO THE RECEIVER AND CONFIRMED TO THE SENDER WITHIN SECONDS

Technology has changed consumer and business expectations in payments. Immediate payment options are available in key markets despite the lack of interbank immediate payment infrastructures. In some countries, banks offering alternatives to immediate payments actively market apps to their own customers, and in some countries banks even partner together to offer an immediate P2P payment experience to a wider customer base. Though these arrangements are not ubiquitous in the way cards and cash are, they have contributed to the change in customer expectations. And as more and more areas of our lives become enabled with 24/7 access – email, online shopping, streaming audio and video – consumers and businesses increasingly expect banks to be online 24/7.

How immediate payments can keep banks at the center of payments

Many banks view immediate payments with trepidation, as they worry that the development of an immediate payments infrastructure could threaten existing revenue streams such as lucrative card and wire payments or could potentially reduce or even eliminate float for cross-border transactions. Some of these worries are exaggerated. Volumes in the UK's Faster Payments system have grown steadily since its introduction in 2008, while volumes in the CHAPS RTGS system (as well as the Bacs bulk ACH system) have also grown slightly over the same period, with no evidence showing a loss of per transaction revenues for banks.

This does not mean that immediate payments will have no effect on legacy revenue streams. Apps utilizing immediate credit transfers at the point of sale are extremely attractive to merchants that wish to avoid high credit/debit card interchange fees. And while not a common practice at the moment, banks sending cross-border transactions between two countries with immediate payment systems may find that the speed of payment processing on both ends can reduce or eliminate float taken when holding funds in transit from one country to another.

Immediate payments do have the potential to decrease lucrative revenue streams. But by narrowing their focus on these negative effects, banks risk missing out on the myriad of opportunities it presents not only for themselves, but for consumers and businesses as well. With wide stakeholder cooperation and a renewed focus on the innovation it can help unlock, immediate payments can benefit all payment system stakeholders. And by keeping the bank account at the center of payments, it can help ensure that banks remain integral to their customers' banking and financial needs.

The following sections examine use cases for immediate payments that benefit consumers, businesses, and banks, as well as use cases that benefit all three stakeholder groups at the same time.

Consumer benefits

Much of the focus on how immediate payments change the payments landscape is on consumers. Indeed, consumers stand to benefit greatly from expanded access channels, 24/7 access to payments functionality, and immediate security and funds visibility.

24/7 payments functionality

One of the major advantages of immediate payments for consumers is the integration of payments functionality with the mobile phone which gives them access to immediate funds transfers 24/7. This offers many benefits, including convenience for consumers who can pay bills at the last minute or purchase goods outside of traditional business hours and ease of use which could help friends split a dinner bill or allow a consumer to make a real-time payment at the point of sale. It also meets the expectations of millennials as they enter decision-making positions in businesses and constitute a growing percentage of consumers. There is already proof that these benefits are being embraced in countries with immediate payment systems, as the UK's Faster Payments system sees volume peaks outside of traditional business hours.

The development of a proxy database that links consumer proxy names or numbers (e.g. email address or mobile phone number) to bank account details can be crucial to adoption, and can ensure convenience and security when sending or receiving payments. Sweden has developed Swish, a 24/7 mobile payment platform that utilizes Bankgirot's BIR immediate payments infrastructure, allowing customers of Swish participating banks to send and receive payments using their mobile phone number in real-time.

Certainty of payment status

When payments are sent or received immediately, end-users always have an accurate view of the status of their bank account because there are no pending payments. Having both payments functionality and account status visibility available 24/7 provides an opportunity to offer additional value-added services such as a budgeting app integrated as a default setting on a customer's banking app, thus allowing customers to link their payments with personal budgets without using a third party app. As the use of electronic payments grows, manual budgeting habits (i.e. through balancing a checkbook every week/month) become less and less common. But most consumers still need to maintain a budget. Existing budgeting apps such as iBank, You Need A Budget, and Mint offer transaction synchronization to bank accounts, credit cards, and other accounts, but they do not all do this in real-time and these third party apps cannot be linked to any existing functionality that could be offered as an integrated solution within a bank app.

Integrating a budgeting app directly with a consumer's banking app can allow end-users to monitor funds to ensure that enough is available for important bills such as rent/mortgage, credit cards, or loans. Banks could also take advantage of this increased visibility into customer funds availability and budgeting to offer short-term loans to cover temporary shortfalls or cross-sell other bank services. Customers will find this type of dynamic bank consultation useful, which can help banks increase customer stickiness, gain new revenues, and maintain the bank account's role at the center of the payments ecosystem.

Key takeaways for consumers

- 24/7 payments functionality on the mobile phone will make non-cash payments easier, thereby limiting the need to carry cash or cards at all times.
- The development of a proxy database will make sending or receiving immediate payments convenient, secure, and ubiquitous.
- Immediate payments at the point of sale could lead to increased loyalty points to attract customers and lower retail prices as merchants save on interchange fees, terminal upkeep, and cash management.
- Integrated budgeting apps can help consumers budget their finances and save money for future purposes and prevent them from going into debt.

Benefits for businesses

As immediate payment systems proliferate around the world, corporates, small businesses, in-store and online merchants have come to see the benefits it can provide in previously overlooked areas such as B2B payments. Whether in the form of improved invoicing terms, just-in-time stock management, payments reconciliation using ISO 20022, or other use cases such as payments at the point of sale, businesses stand to gain from the development of immediate payment systems.

Room to breathe: freeing up working capital

Immediate payments enable businesses to offer improved invoicing terms to suppliers that can help increase working capital. This is particularly beneficial in capital-intensive industries such as shipping. A company with a global supply chain could offer to pay suppliers a percentage of the fee (i.e. 10%) when the goods are loaded onto a ship, the next 10% when it arrives at the first port, and continue this practice until the goods arrive at the final destination, whereupon the remaining price is paid in full. Connecting the payment to the tracking and tracing of a good can enable auto-generation of invoices at each of these gateways, freeing up capital for both sides and could enable suppliers to offer discounts in exchange for the added working capital freed up by immediate invoice payments. Discounted invoicing is common in some countries without immediate payment systems, and the additional functionality of immediate invoice payments (or partial invoice payments along the supply chain) could take this practice one step further.

Immediate B2B payments can help retailers free up working capital by enabling just-in-time stock management for expensive retail items. Small businesses selling large kitchen appliances such as refrigerators or other large home appliances could free up a substantial amount of working capital by paying suppliers with an immediate payment once the customer makes a purchase and have the product(s) delivered same day or next day. These types of large, expensive products are typically planned by consumers in advance, and often require delivery since customers do not expect to purchase the product in-store and bring it home right away. Using immediate payments to pay suppliers and then directly delivering the product to the customer can save retailers a substantial amount of capital that is otherwise tied up by carrying inventory, and should increase margins by avoiding discounts to clear excess or obsolete inventory. Retailers could pass some of these savings on to their customers, which could work to increase overall sales and improve customer loyalty. This is already taking place in the UK, where the Faster Payments system is enabling just-in-time stock management for small retailers.

Improving payments reconciliation

The use of ISO 20022 for immediate payment systems around the world provides significant benefits for businesses by easing payment reconciliation. ISO 20022 messages can hold extensive remittance information that goes well beyond most legacy standards used in payment systems today. This increase in remittance data is vital to payments reconciliation for businesses of all sizes. The rich remittance information contained in ISO 20022 messages is a key factor for choosing ISO 20022 in countries such as Australia and Canada, which both have legacy standards that only allow for less than 50 characters of remittance data.

Changing the game for commerce

In addition to giving consumers 24/7 access to payments functionality via mobile phones, immediate mobile payments offer significant advantages to retailers at the point of sale. Allowing customers to pay via an immediate mobile credit instead of using a debit/credit card means that retailers can avoid or reduce the amount they have to pay in interchange fees. In countries where consumers are less accustomed to using cards, the ability to pay electronically with an immediate payment at the point of sale could lead to fewer overall cash transactions at retailers.

Innovation in point-of-sale payments has been rapid, and if immediate payments become more popular at the point of sale, merchants could one day eliminate the need for any payment terminal, instead using a dongle, QR code, or mobile-to-mobile payment. The savings merchants would make on reduced interchange fees, card terminal upkeep, cash management, and card-acquiring fees could then be passed on to consumers. The UK is poised to go live in 2015 with Zapp, a POS service that allows customers to pay for goods using the Faster Payments infrastructure. In Poland, merchants have accepted mobile payment apps at the point-of-sale for years to avoid high interchange fees for card payments. With the Polish banking community creating common standards for mobile payments last year, it would not be surprising to see a rise in mobile POS payments using the Express ELIXIR immediate payment system.

Key takeaways for businesses

- Auto-generation of invoices, payment tracking, and just-in-time inventory management can help increase working capital for individual organizations and across regional/global supply chains.
- ISO 20022’s extensive remittance data eases payment reconciliation for businesses of all sizes. This is a huge improvement over legacy data standards in some geographies.
- Mobile payments at the point of sale or for e-commerce can be attractive for merchants to avoid interchange fees and chargebacks associated with other payment types such as cards. If enough customers pay with immediate payments instead of with cash or cards, merchants can also save on terminal and cash management costs.

Bank benefits

Immediate payments can help banks gain revenue that they are currently losing to non-bank payment providers as well as offer new payment products to target P2P payments, P2B payments (such as bill payment services or POS/e-commerce payments), and B2P payments (such as for hourly worker salary payments or insurance payouts). Banks also have the opportunity to pursue internal enterprise payments renovation and retire outdated legacy systems. Such internal harmonization and efficiency can create benefits for banks that go beyond real-time payments, including enabling them to create products and services that consolidate banks' role as the provider of choice for financial services.

Capitalizing on internal investment with ISO 20022

Immediate payments require a significant investment in infrastructure from the wider stakeholder community. But the internal investment at individual banks (in the form of modernizing IT systems, improving fraud detection, and updating business practices) is an even bigger challenge. This internal investment in time and money can provide benefits to the entire bank that go beyond just payments and the adoption of immediate payments, but it should be done proactively. It is vital that banks prepare now for infrastructure impacts even if the introduction of immediate payments is still a few years away from reality.

A key enabler of such internal IT renovation, as well as for immediate payments in general, is the use of the ISO 20022 data standard. ISO 20022 has recently become the default data standard for immediate payment systems around the world. Systems built within the last several years (e.g. in Denmark, Sweden, and Poland) all use ISO 20022. Almost all immediate payment systems currently in development (such as Australia, Canada, and the United States) plan to use ISO 20022, and stakeholders in countries with immediate payment systems that use other standards (such as ISO 8583 or proprietary standards) have stated publicly that a move to ISO 20022 would be beneficial in the future.

ISO 20022 is attractive due to its capacity for extensive remittance data, the ability to reuse ISO 20022 messages across multiple business areas, and the fact that it is a modern, flexible XML-based standard. A bank that invests in ISO 20022 gains unprecedented flexibility to respond to future challenges in the payments system, a huge advantage for large banks that have a major presence in one or more markets. ISO 20022 benefits both the payment system as a whole, as well as individual organizations looking to increase processing efficiency, simplify internal infrastructure, and lower costs.

Individual organizations can utilize ISO 20022 for payments renovation in two different ways. The first is through a wholesale migration from an internal legacy format to ISO 20022, which enables an institution to move beyond the constraints of legacy platforms. The second way ISO 20022 can be used to improve internal IT infrastructures is by enhancing the functionality of legacy platforms. This can come either by using ISO as a "bridge" between two legacy standards that have been mapped to ISO 20022 or by using ISO 20022 to enrich the functionality of a legacy standard. One example of this is by sending a parallel message with a legacy payment message that contains extra remittance data. Even if a payment system or individual organization chooses not to completely replace a legacy standard and instead opts to use payments orchestration technology to bridge the gap between legacy standards and more modern standards, ISO 20022 can help protect legacy investment and improve the functionality of existing data standards.

Use cases banks can target with immediate payments:

P2P – P2P mobile payment applications that allow customers to send and receive immediate payments could move P2P payments away from cash. Whether a bank develops its own P2P app or partners with a third party that already offers this functionality (i.e. PayPal, Venmo), the value proposition for customers is strong.

P2B – Using immediate payments to make last minute bill payments or to purchase goods at the point of sale or online would offer huge value to consumers that today have to plan bill payments in advance, have trouble using cards for some e-commerce transactions, or who have to rely on cash or cards at the point of sale. It can also aid the adoption of e-invoicing or EBPP options by moving consumers away from direct debits, which feature high variability due to extensive refund rights and thus lead to numerous complaints to banks.

B2P – Businesses that pay hourly wages to workers can use immediate payments to disburse wage payments at the end of a day or week, and insurance companies can use immediate payments to quickly settle a claim with customers once it is confirmed.

B2B – Immediate payments enable businesses to improve working capital by offering improved invoicing terms and just-in-time stock management. It could also enable same-day cross-border payments for international businesses.

Key takeaways for banks

- Offering innovative and useful products and services built on an immediate payments infrastructure can help meet consumer and business needs and lead to greater satisfaction among bank customers. Banks can leverage the trust they have with their customers and provide innovative services that will increase customer stickiness, boost revenues, and solidify the bank's role at the center of payments.
- Developing an immediate payments infrastructure is a good opportunity for banks to pursue internal payments renovation, either across the organisation or for specific business areas. Investing in internal IT can ensure future flexibility and innovation while minimizing some or all of the constraints posed by legacy infrastructures.
- ISO 20022 is a key component of many immediate payment systems. Banks can also use ISO 20022 for internal processes and to improve remittance information and product development.

Benefits to all stakeholders

While some of these immediate payment products and services mainly benefit one or two stakeholder groups more than others, there are other developments that offer broad benefits to consumers, businesses, and banks. Establishing open APIs for payments communities and tokenizing bank account data to bolster the security of payments allows consumers and businesses to access innovation and secure products that meet their needs while strengthening banks' position at the center of payments.

APIs: the gateway to innovation

The establishment of community-wide open APIs has the potential to increase innovation and help banks stay competitive, win business, and retain their relevance at the center of payments. Non-bank payment providers have already found their role in the payments space. While no non-bank payment provider offers the full suite of payment (and banking) services that banks of all sizes offer today, many non-banks offer targeted, niche payment products that offer more value to consumers and businesses than products offered to them by their bank. Banks struggle to innovate as fast as small non-bank providers that offer a very targeted value proposition to customers. But this does not mean that banks have no role to play in innovative payment products. Creating open APIs that non-banks can use to gain access to customer bank accounts can create financial markets centered around banks, which would remain the gateway for consumer and business payment services.

While this idea may sound alarming to banks at first, it actually opens the door for a more collaborative and innovative payment system as a whole. By gathering community stakeholders together (banks, non-banks, corporates, consumer groups, etc.) to develop open APIs, non-banks are brought into the payments space on the banks' terms. Non-bank providers can continue to create targeted, innovative products and pay banks a fee to gain access to customer accounts in accordance with the appropriate laws and regulations surrounding API banking. And with open APIs, non-banks could access bank accounts directly without having to go through as many application layers as they do today.

Consumers will benefit by having access to innovative non-bank products that are directly linked to their bank account, thereby avoiding the need to create multiple non-bank payment accounts that are not interoperable. Businesses benefit by being able to accept non-bank payment products using the immediate payments infrastructure instead of accepting card payments (and thus paying interchange fees and managing chargebacks) or direct debits (which can be returned weeks or months after a purchase is made). And banks benefit by providing regulated access to customer accounts for a fee and by maintaining their role at the center of financial services. When looking for non-bank providers to partner with, banks should focus on providers that offer extensible solutions that can scale to a wider audience and higher volumes in order to facilitate an ecosystem that fosters competition and innovation.

Developing open APIs helps reduce inefficiencies and the potential for error that currently exists in a fragmented ecosystem between the bank account and the final payment platform or product. The UK and EU have recognized this, with both communities in the development stages for creating open APIs that offer limited access to bank account details. Developing such open APIs is a collaborative process and can help foster partnerships between banks and non-banks that benefit all stakeholders in the wider payments community.

Security and convenience through tokenization

The tokenization of bank account data for immediate payments will benefit all stakeholders by decreasing levels of fraud, increasing payment finality, and making it easier to send and receive payments. Tokenization can take two forms: masking sensitive bank account information with a one-time "token" during a transaction authorization at the point of sale or linking bank account information to a persistent number or name such as a mobile phone number or email address to avoid customers having to divulge their bank account numbers when sending and receiving payments. In both cases, tokenization can boost security and convenience for consumers, businesses, and banks.

For consumers, tokenization can assuage security concerns related to new payment channels such as mobile payments. Whether it is a one-time token unknown to them at the point of sale or the use of a proxy number instead of a bank account number, consumers feel more comfortable knowing that their bank account information cannot be compromised every time they make a payment. Additionally, the use of a proxy number instead of a bank account number makes sending or receiving payments much more convenient for consumers, which can lead to an overall increase in electronic payments. For businesses, the use of tokenized immediate payments brings the benefit of potentially reducing card payments and/or direct debits, which means fewer chargebacks. Immediate payments give businesses a more accurate view of working capital and offer more finality for accounts receivable. For banks, the decreased levels of fraud that tokenization can help bring about means that internal resources are able to focus on other matters such as product development or client services.

Key takeaways for all stakeholders

- The development of open APIs has the potential to connect banks, which offer regulated bank accounts and wide reach, with non-bank payment providers, which tend to offer innovative niche products. The collaboration would enable near-ubiquitous, innovative products to consumers and businesses. This collaboration helps banks to retain their customer relationships while offering more targeted products. Non-banks can use the partnership to expand their reach and gain access to customer data. Consumers and businesses will benefit through access to a full spectrum of innovative products and services from a centralized access point – bank accounts.
- Tokenization of bank account data, either in the form of single-use tokenization at the point of sale or via a multi-use proxy such as a mobile phone number, can increase convenience and security. This can lead to a higher number of non-cash payments, a move away from interchange associated with cards and decreased levels of fraud.

Conclusion

Immediate payments should be embraced by the payments industry. They present an opportunity to develop modern products and services that fulfill consumer and business needs. By leveraging customer relationships and developing products that satisfy customer expectations, banks can ensure that they remain at the center of payment services. Banks need to plan ahead in order to take advantage of the opportunities immediate payments offer. Pursuing internal payments renovation to reduce IT siloes or implementing payments orchestration technology can give banks the flexibility to develop innovative products using immediate payments. A strategic approach should be taken that focuses on the benefits consumers and businesses will realize from immediate payments. Providers that offer extensible solutions can help meet consumer and business expectations of speed, convenience, and security. By making its customers happy, whether through new products developed internally or by partnering with non-bank payment providers, banks can increase customer satisfaction and entrench their role at the center of payments.

About ACI Worldwide

ACI Worldwide, the Universal Payments company, powers electronic payments and banking for more than 5,600 financial institutions, retailers, billers and processors around the world. ACI software processes $13 trillion each day in payments and securities transactions for more than 300 of the leading global retailers, and 18 of the world's 20 largest banks. Universal Payments — UP — is ACI's strategy to deliver the industry's broadest, most unified, end-to-end enterprise payment solutions. Through our comprehensive suite of software products and hosted services, we deliver solutions for payments processing; card and merchant management; online banking; mobile, branch and voice banking; fraud detection; trade finance; and electronic bill presentment and payment. To learn more about ACI, please visit www.aciworldwide.com. You can also find us on Twitter @ACI_Worldwide.

About Lipis Advisors

Lipis Advisors is a leading strategy consultancy specializing in the payment sector. Lipis Advisors are experts on payment systems, services, and strategy, as well as the underlying technologies that support payment infrastructures. Lipis Advisors advises on all forms of payments, including ACH payments, real-time payments, card payments, cheques, mobile payments, online payments, and RTGS/wire payments. To learn more about Lipis Advisors, please visit www.lipis.net.

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