THE PROMISE OF ISO 20022 IN PAYMENTS: FROM STANDARD TO VALUE
WHAT MAKES A STANDARD SUCCEED?

ISO 20022 is often described as the solution to the proliferation of payment formats that form the world’s payments ecosystem. It has quickly become the de facto standard where all systems will eventually migrate. Recognizing the achievement of “standard” is a feat unto itself, yet realizing the full potential of ISO 20022 makes this a cause worth pursuing.

Standards succeed when they achieve critical mass and consistency of use. The value of a standard is quickly diluted if users make bilateral arrangements to overload or circumvent usage rules, at which point the standard no longer serves its fundamental purpose as a common language.

In the payments domain, the SWIFT FIN standards have been extremely successful. First, the standard was well designed to be clear and concise, and it has been amended in an orderly way. The governance model for SWIFT standards is based on a strong central authority, only the most current version of the standard is accepted, and there is continual communication and education.

Rigorous enforcement is possible because almost all messages following the standard are processed through SWIFT’s central switches, and non-compliant messages do not get through the SWIFT network. There is little reason to circumvent the standard for the small fraction of messages that will go via other communication channels.

Domestic ACH schemes in many countries have been similarly successful, also with strong standards bodies to define the standard syntax and usage rules, education programs and an orderly protocol for amending the standard. This has been achieved in various instances without a single central clearinghouse to force standards compliance.

ISO 20022 starts with the ambitious goal of unifying financial message standards, of which payments, the topic of this analysis, is addressed by only a few of the numerous categories. Benefiting from the cumulative knowledge from surveying the many standards that have come before, ISO 20022 provides a clear and comprehensive language for expressing the rich variety of information that accompanies payment instructions with many distinct purposes. It is here that the rich opportunity presented by ISO 20022 can be unlocked.

Yet, ISO 20022 for payments is often misunderstood to be more than is intended. The standard defines messages with clarity of purpose for each message type. The purpose is to convey information between parties in the payment chain, as an instruction from the originating corporation to a bank, to pass settlement information among multiple banks that are involved in the settlement of the payment or to deliver a report about the payment.

However, it is not a payment information model, and in particular it does not define all of the metadata that is required to maintain the payment state, execute a complex business process surrounding the payment and maintain the audit trail. But it defines a useful subset of the information in the payment information model.

ISO 20022 does not have the simple governance model that has been critical to the success of SWIFT FIN. There is already a proliferation of ISO 20022 XML schemas and usage guides for different payment schemes, both from the payment schemes themselves, and also from specialized industry groups like the EPC (the European Payments Council) and IPFA (the International Payments Framework Association). These equate to dialects within the common language, disallowing or restricting the use of certain fields, for example, more invoice information in a SEPA Credit Transfer payment.

This exposes the standard to the potential pitfalls that have undermined previous payment standards.

AVOID THE PITFALLS, FOCUS ON THE VALUE

First, if the standard does not accommodate all of the information needed for a particular payment scenario, then the participants extend message formats by “overloading” fields and applying them to a different purpose from the intent of the standard, or by using an unstructured field to contain proprietary structured
data. So far, ISO 20022 seems to be holding up against the need to misuse it in this way.

The U.K. Faster Payments scheme is an example of a standard being used as a loose framework. ISO 8583 was heavily extended to address the different payment domains, with very different scheme usage rules, to the point that quite different software is needed both for message format processing and network protocol management.

ISO 20022 offers the flexibility in carrying critical information previously ill-defined or altogether absent from the payments value chain. With the ISO structures, organizations can supply and receive the information critical to automation. Financial institutions can offer services to assist in the migration to such capabilities and offer enhanced reporting and capital management tools related to these improved information flows.

A second pitfall is that participants can continue to use obsolete versions of the standard on a bilateral basis. ANSI EDI X.12 is an example of a standard lacking a strong central authority. There is a history of bilateral agreements to overload message fields, industry-specific variants and widespread failure to migrate to revised versions of the standard. Also, the evolution of the standard has been undisciplined; in ANSI the correct place to map certain data is subject to interpretation in contrast with ISO 20022 where the proper place for a given data element is clear.

The standards committees can avoid such pitfalls by acknowledging it, making changes in an upward-compatible way and even defining the mapping conventions between revisions of the standard. Powerful software for mapping and transforming XML data can help if there is a discipline in the way the standard evolves. Compatibility must consider the end user benefits. As long as there is a continuous feedback cycle driving improvements, revisions to standards will be embraced, or at least accepted, if they are beneficial to the community and not done for the sole purpose of standards alone. Standards bodies should include input from all affected parties in the value chain; this type of collaboration could have benefited the PAIN definitions.

ISO 20022 seems to be overcoming both of these risks despite there being no single central enforcement body. First, the standard benefits from the cumulative experience of problems found in previous inter-scheme mapping attempts. For example, there is enough expressive power to avoid the kind of extensions made to the ISO 8583 standard for Faster Payments. Second, many payment schemes over which ISO 20022 files are exchanged apply validation, which imposes a degree of discipline that carries over to other paths such as direct transmission between banks.

The corporate-to-bank path has been the weak link in the past, because banks compete to deal with proprietary variations or obsolete versions of standards, if that is what it takes to win business. The most promising antidote to this pattern is the dominance of a small number of corporate ERP software vendors, some of whom have committed to compliance with the ISO 20022 standard. Corporations using this software will be able to maintain compliance with the standard because their software vendor has the economy of scale to do so.

Financial institutions have dual opportunities in this space. They can directly benefit from the use of ISO 20022 in the intra-bank space. Operational efficiencies may be gained with more flexible standards such as what the exceptions and investigations initiative offers. Financial institutions could leverage this efficiency further to enhance their offerings and provide improved visibility and transparency to customers while processing transactions. Ultimately this suggests the ISO 20022 standard could source new revenue opportunities when packaged properly.

As SWIFT moves to the MX message standards which are based on ISO 20022, the inter-bank path is expected to have the same adherence to a single version of the standard as has worked so well with the FIN payment messages, and this discipline will carry over to messages and files outside of SWIFT. SWIFT could potentially apply a similar discipline to the corporate-to-bank path. Financial institutions could position themselves as trusted advisors alongside such an initiative. The balance will be in managing change to the corporates. Going forward, usage standards utilizing the defined structures will allow for greater acceptance. A continually changing technical standard will be more difficult to adopt and costly to maintain.

At this time, ISO 20022 shows great promise of keeping a balance between a standard that is powerful and consistently used, yet flexible enough to be adapted to the proliferation of new types of payment offerings that banks and non-banks are creating.
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