Towards a single payments platform

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The worldwide shift to real-time payments is irreversible. The important question is whether the payments industry can migrate to a real-time future that combines the safety and soundness of legacy payments infrastructures with the speed, innovation and service of increasingly powerful digital technology. The path to a workable and stable real-time payments industry will be determined by the responses and interactions of incumbents, new entrants, customers and regulators, says Lisa Lansdowne-Higgins, Vice President, Card Operations and Supplier Management at the Royal Bank of Canada, but she believes they all have a stake in a new paradigm that combines the best of the old as well as the new.

The pace of change in payments services is accelerating so rapidly, it is no surprise that we are now entering the era of real-time payments. The journey to this point has certainly not lacked interest. Among the many factors driving real-time payments forward are demands for greater transparency, the need to widen financial inclusion, growing competition from non-banks, regulatory pressure, and of course the growing coincidence between the speed of technology and consumer demands for faster payments.

Real-time payments is now a top priority in every market. Almost 40 countries have committed themselves to achieving it already. Between them, they represent 75 per cent of all payments processed by automated clearing houses (ACHs) around the world.[1] This means real-time payments are now closer to mainstream than ever. In fact, market participants in several countries now view real-time payments as tantamount to a new form of infrastructure, which exists primarily to enable competition between innovative payment service providers.

Infrastructure as an enabler

Faster Payments in the United Kingdom, for example, provides a faster payments service that enables banks to develop a range of competing payments products with many different features. Used in this way, real-time payments infrastructures are not a product or service in their own right. Rather, they act as enablers for other products and services. However, this does present the industry with a challenge. It is to create a new payments eco-system that combines the efficiency and resilience of a market infrastructure with the new product and

1 Gareth Lodge, *Faster Than A Speeding Payment: The Race To Real-Time Is Here*, Celent, June 2016.

service possibilities of technology in a way that is both safe and sound.

The current configuration is a mixture of the old and the new. Payment systems that clear and settle cheques invented centuries ago sit alongside digital systems that clear and settle payments in seconds. The industry has devoted endless human and material resources to the development, maintenance and integration of a multitude of systems that support transactions across a wide variety of "schemes,"[2] each of which operates to different rules and technical standards for executing payments. It is worth asking whether these older methods are still required when the technology exists to settle transactions in real-time.

There must come a point at which the industry ceases to support older infrastructures and migrates clients and payments to their successors. The question we must ask ourselves is this: is there a need to differentiate between settlement streams on grounds of legacy alone? If every form of payment is simply a transfer of value, a single system ought to be able to support every type of payment, while assigning different attributes to each payment according to its behavioural and risk characteristics. This prognosis is consistent with the emerging consensus that a real-time infrastructure can support a variety of innovative "overlay" services.

Current stakeholders will shape the future

Whether this vision of the future is realised depends on the response of incumbents and new entrants, and their customers and regulators, to the challenges and opportunities presented by real-time infrastructures. Their reaction will determine the pace at which payment systems are rationalised, but their response is not entirely under their own control. The wider environment will shape their behaviour, in the same way that external factors have driven the rise of real-time payments to the current decision point.

For a start, the development of real-time payment systems has advanced in tandem with regulatory moves for open access to the payments markets by non-banks. Unencumbered by legacy systems, non–banks are inevitably nimbler than incumbent banks. They can alter the structure of the eco-system by offering innovative services that are more relevant to the retail and corporate customers of the digital age. New entrants rarely

2 "Scheme" is payments industry shorthand for a collection of business rules and technical standards for the execution of payment transactions within a particular community.

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> **- Lisa Lansdowne-Higgins, Vice President, Card Operations and Supplier Management at the Royal Bank of Canada**

compete head-to-head with incumbents by offering traditional forms of payment. Instead, they focus on the entire client experience, and look to bundle various components in ways that impress potential clients with their desire to build a relationship with the customer.[3]

A gradual rationalisation of payment platforms

For incumbents lumbered with legacy payments systems, access to ACHs and real-time gross settlement systems (RTGSs) was once a major competitive advantage. It might now be viewed as a handicap. Incumbents find themselves juggling a multiplicity of legacy payments types and services. Rather than continue to do so, incumbents may find they are better able to compete by migrating to fewer platforms. By eliminating the inefficiencies that stem from operating multiple payment systems, incumbents will be able to streamline their operational processes, which will in turn enable them to lower their costs.

But this transition cannot be accomplished by simply closing existing payment systems down. Instead, incumbent banks need to buy time to compete effectively with new entrants. One way to do this is to steer payment volumes to newer platforms by highlighting their service benefits. By this means, less economic methods of payment will run their natural course. Simply put, incumbents need to continue to invest in newer payment methods, while allowing older services to be wound down. It is a solution which provides customers with a choice over how and when to transition their business to a new platform, while allowing incumbents to maintain support for long-established relationships.

The cost of investment in new methods of payments may even fall over time. Real-time payment systems are already being developed in a more modular and flexible way that allows infrastructures and their users to adopt new features quickly and add scale easily. New approaches, such as those promised by distributed ledger technology (DLT), might accelerate the realisation of these benefits still further. In fact, the rapid pace of change in technology, and the growing ability of technology to support new tools, is one of the strongest arguments for the rationalisation of payments systems.

Conflicting customer expectations

In choosing the timetable for rationalisation, customers present incumbents with a dilemma. Their response to the availability of real-time payments is far from uniform, but it divides into two main categories. First, a significant group of customers want the benefits of new technology to be reflected in the payments services they buy. They expect payments to be easy, convenient and immediate. At the same time, another sizeable group of customers are not yet ready to part with tried and tested methods of payment.

This obliges incumbents – unlike new entrants, which have no legacy clients - to continue to support a variety of payments systems. This dilemma may well be resolved by the passage of time. As Millennials become the largest segment of the population, customer expectations will converge on a single model: real-time, digitised, always-on, and available 24/7/365. Reliance on older, non-digital types of payment will diminish in line with the changing demography of the world. Eventually, the case for fewer payments systems will become unanswerable.

Regulators want resilience more than competition

The last group of stakeholders which will influence the pace of adoption of real-time payments is the regulators. For them, safety and efficiency far outweigh lowering the barriers to entry to payments markets.[4] Since efficiency – if not safety – argues for rationalisation, regulators can be expected to support a reduction in the number of methods of settling payments. For the same reason, they can also be expected to support further standardisation of payment flows, including adoption of ISO 20022 by real-time infrastructures, new providers of payments services, and incumbents.

Conversely, rationalisation of payments systems creates risks that might give regulators pause. Chief among those risks is the increased operational risk of reliance on a single system for all types of payment. Of equal concern is how best to ensure continued vigilance about cyber-crime, and effective management of cyber-threats as new payment systems are introduced. These considerations will encourage regulators to insist on higher standards of resilience.

But there are commercial as well as systemic reasons to ponder whether a reduction in the number and range of payment systems is a good idea. Will a single platform put the financial services industry in a better position to compete with the new technology start-ups that are disrupting the payments market today? Will the innovation cycle shorten or extend, as all parties begin to compete with each other off a single platform? Customers of payments service providers may resist rationalisation for that reason: it could reduce the intensity of the competition for their business. While almost everybody in payments recognises that the availability of real-time payments means the industry is at a structural turning point, it is important the eventual outcome strikes the right balance between innovation, competition and safety and soundness.

"Towards a single platform for all payments ..." at Sibos

Wednesday 28 September 2016
10.15-11.15
Conference Room 2

3 Gareth Lodge, *Breaking the payments dam*, Celent, November 2015.

4 Stuart E. Weiner, *The Federal Reserve's Role in Retail Payments: Adapting to a New Environment*, Federal Reserve Bank of Kansas City, Fourth Quarter 2008.