

TOWARDS A SINGLE PLATFORM FOR ALL PAYMENTS¹

Panellists agreed that the worldwide migration to real-time retail payments will deliver faster payments and innovative services for retail investors and merchants, including cheaper and speedier payments across borders. However, building a working, multi-functional payments platform, warned the members of the panel, will require consolidation of domestic systems, simplification of payment channels, and interoperability across borders. The panel concluded that the benefits must also be balanced against the risks, given the systemic importance of payments systems and platforms.

¹ See also "Towards a single payments platform," Market Infrastructure Forum magazine, issue number 4, Sibos Geneva, September 2016, pages 80-85.

The payments industry is migrating to real-time retail payment. In 40 countries, which between them account for three out of every four payments processed by automated clearing houses (ACHs) throughout the world, payments banks and payments market infrastructures (PMIs) have confirmed their commitment to settling retail payments in real-time. There remains ample room for debate about how to attain this objective, and on what timescale, but the trend to real-time retail payments on a global scale is now unmistakable.

The trend is driven by multiple factors. They include consumer demand for instantaneous payment, the emergence of competitive payments services from outside the banking sector, a reduction in the use of cash to settle transactions, and of course the availability of cheaper and more powerful digital technology for those payments service providers that are modernising their platforms. Lately, central banks have added to the pressure for faster retail payments, because they see it as a way of reducing systemic risk, increasing transparency into transaction costs and fostering competition in the payments industry.

In Europe, for example, as Marc Bayle, Director General of Market Infrastructure and Payments at the European Central Bank (ECB) pointed out, has made instant payments one of the three action points in its strategic review of the development of its payments (TARGET2) and securities (T2S) market infrastructures.¹ The fact that the ECB places instant payments in the context of a wider infrastructural reform is a reflection of the fact that the transition to instant retail payments cannot ignore what exists already or be accomplished in isolation from wider considerations, such as market integration and the management of systemic risk.

¹ See Yves Mersch, "The Future at your fingertips – the European market infrastructure of tomorrow," Market Infrastructure Forum magazine, issue number 4, Sibos Geneva, September 2016, pages 24-30.

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- Andrew Hauser, Executive Director for Banking, Payments and Financial Resources, Bank of England

As the audience for the panel at Sibos in Geneva on 28 September this year heard, the successful implementation of an instant retail payments platform, and particularly one that functions across national borders, hinges on a series of developments. They include consolidation (of existing payments platforms), simplification (of payments methods), openness (to new entrants), and inter-operability (between platforms in different sectors and countries). The ECB has also argued that instant payments within the eurozone require the support of a borderless collateral management system. This is to ensure banks have ready access to the eligible collateral they need to settle in central bank money.

Without inter-operability, fragmentation looms

This matters, because a major concern of the ECB about the evolution of instant payments systems in Europe is that the development of national platforms might fragment European payments markets, undoing the slow but steady progress towards a single European payments area. To that end, the ECB is working with the Euro Retail Payments Board (ERPB) to encourage the provision of a pan-European instant payment infrastructure that will be open to use by payments services providers of all kinds no later than November 2017. The adoption by the ECB of the ISO 20022 standard for both T2 and T2S is a further measure designed to make inter-operation between payments systems across national borders simpler, cheaper and more transparent.

Tony Brady, Head of Global Product Management for Treasury Services at BNY Mellon, emphasised to the panel the importance of inter-operability. “When I travel abroad and turn on my mobile phone, within seconds I am automatically connected to the domestic telecoms provider and can immediately call or text virtually anyone in the world despite having no relationship with that company,” he told the panel. “The same level of efficiency and co-ordination is not evident with cross-border payments. As an industry we sometimes struggle to tell a client how long a payment will take, how much it will cost or provide a payment status

information update when the payment is in transit. When I think of a single platform, I am not thinking of a single piece of software, but rather, a single global real time payment experience.”

Miguel Diaz Diaz, director of payment systems at the Banco de Mexico, told fellow-panellists that a single payments experience was now close to realisation in Mexico, through inter-operability between banks, payments systems and other infrastructures. The Sistema de Pagos Electronicos Interbancarios (SPEI) system, operated by the central bank, allows consumers to make electronic payments instantly to non-banks as well as banks.

Simplification facilitates competition

This has helped new entrants to the payments services industry get traction in the domestic marketplace. “The Mexican system enables the connection among all of the banks and some regulated non-bank financial institutions to facilitate real-time payments,” explained Diaz to the panel. “SPEI has a common language, although it communicates efficiently with other financial market infrastructures through translations.”

A comparable single experience is a distant prospect in most European countries. Andrew Hauser, executive director for banking, payments and financial resilience at the Bank of England, described to the panel the present degree of fragmentation in payments in the United Kingdom. Retail payments, he said, can be made by cash, cheque, credit or debit card, on-line via the Faster payments systems, or by net batch payments through Bacs. Inter-bank payments can be made through the RTGS system via CHAPS, while cross-border payments can be routed through correspondent banking networks, direct links between RTGSs, or via CLS.

“Taken together, one can easily list ten or 15 payment pathways without even trying,” said Hauser, who used an extended railway metaphor to explain the fragmentation which results. “People wanting to travel north out of London by train are spoiled for choice,” he said. “Spread along a half-mile stretch of Euston Road

are no less than three major stations: Euston, King’s Cross and St. Pancras. Each provides slightly different facilities, with trains ferrying passengers at different speeds to different locations. But the basic service – train travel – is much the same in all three cases, and many of the destinations served by different stations are within a few miles of each other. Indeed, some are identical. The situation in UK payments today is rather similar.”

So it is not surprising that the Payments Strategy Forum in the United Kingdom has called for a Simplified Payments Platform, not least to make it easier for new entrants to offer competitive services.² Indeed, a principal purpose of the consultation the Bank of England launched into the future of its RTGS system in September 2016 is to work out how to simplify and consolidate the array of payment methods available in the United Kingdom.³ Like the ECB, the Bank has already adopted the ISO 20022 standard as the key to inter-operability between competing payments systems and providers.

Distributed ledger technology not yet a magic bullet

Indeed, a major concern among panellists about the use of distributed ledger technology (DLT) in payments was that lack of standardised ways to exchange information would inhibit inter-operability between DLT networks. As Tony Brady pointed out, this would undermine the goals of consolidation of payments platforms, simplification of payments techniques, and seamless interaction between payments systems. “If there are no standards, then it is simply a case of closed groups co-operating with each other but not attaining any scale,” he said. “Creating industry standards will result in network effects, which will create scale and critical mass.”

² Payments Strategy Forum, “*Being responsive to user needs: A draft strategy for consultation*” July 2016.

³ Bank of England, “*A new RTGS service for the United Kingdom: safeguarding stability, enabling, innovation*,” A consultation paper, September 2016.

It was for this reason that panellists emphasised that any new or consolidated payments platforms system must be capable of interfacing with DLT. They were less convinced that DLT would supplant established payments platforms. While recognising that DLT could in theory displace centralised infrastructures (by allowing counterparties to exchange value via distributed ledgers) and potentially save payments banks millions in liquidity and collateral costs (by settling payments with immediate finality), panellists thought regulations would inhibit rapid adoption of a technology whose flaws and vulnerabilities are not yet fully understood.

While they noted that regulators are enthusiastic about the transparency and cost savings promised by DLT, panellists argued central banks in particular would not want innovation to be purchased at the expense of stability. They also expressed concern about the risk of overlapping, or even contradictory, regulation of the DLT networks developing, with the attendant risk of a race to the bottom in terms of systemic security and stability. "It is critical that the industry engages with regulators about DLT," warned Tony Brady. "It is imperative to get regulators on-board."

Andrew Hauser reinforced this view, arguing that the systemic importance of payments systems means they must adhere to a failure-not-an-option philosophy. "Payments must operate to the highest standards of resilience, and be capable of dealing with new technological threats as they emerge," he said. "The challenge is how to design in that resilience during 'peace time.'" He advocated the use of so-called "chaos monkeys" software code, designed to find flaws in coding, plus routine stress-testing of the technology underpinning payments services.

Naturally, panellists acknowledged that consolidation of centralised payments platforms potentially increased systemic risk, by creating a single point of failure. Market infrastructures are already the object of continuous cyber-attacks, some of which have resulted in successful denial-of-service attacks, embarrassing data leaks and unwanted disclosure of proprietary information. "Cyber-resilience is key and organisations have to invest huge sums of money so that they can

adequately face these new challenges and threats," said Miguel Diaz Diaz, director of payment systems at the Banco de Mexico.

Striking the balance between risk, innovation and meeting consumer expectations

The countervailing view – that a single platform would prove more resilient than the existing, decentralised and fragmented collection of payment systems – was also expressed on the panel, chiefly on the grounds fewer systems reduce the risks of cross-system contamination. But there was complete consensus on the panel that any payments infrastructure, whether it is centralised or distributed, had to be as close to inviolable and invulnerable as possible. Panellists accepted that considerations of this kind would inevitably slow down the pace of the migration to real-time retail payments, and the adoption of new technologies such as DLT.

However, the panel agreed that safety and security have to be balanced against rising customer expectations. As Andrew Hauser pointed out, one of the main purposes behind the reform of payments market infrastructures is to encourage new entrants, innovative services and greater competition. "Those of you particularly familiar with London's King's Cross station will know that there is a spot, ironically between platforms 8 and 9, where a half-submerged luggage trolley commemorates the mythical 'platform 9¾' from Harry Potter," said Hauser. "Platform 9¾ is of course the gateway to the magical secrets of Hogwarts – but is invisible to 'muggles,' i.e. normal human beings, requiring travellers to fling themselves head-first at a potentially unyielding wall to gain entry. If there may have been some parallels between this fictional construct and the role of RTGS in the past, both in the vital role it plays, and in its relative obscurity, it is our firm intention that there should not be in the future."

"Towards a single platform for all payments"

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