Your guide to the real-time payments revolution

The biggest trend in financial services right now is not fintech nor the blockchain; it is the move from batch to real-time. This is the view of Tony McLaughlin, Managing Director, Emerging Payments and Business Development, Treasury and Trade Solutions at Citi. In this article, he charts a course for the payments industry, providing some action points for treasurers.

When the UK launched Faster Payments in 2008, it ushered in a new era for payments around the world: the age of real-time had begun. Many other countries soon followed suit, announcing the completion of their own instant payment rails. By 2020 faster payments will be ubiquitous in all major markets.

The proliferation of digital businesses and the rise of eCommerce has been the key driving force behind this rise. Businesses thrive when they offer their customers a quick, efficient and user-friendly payment method. They have demanded changes in the infrastructure to facilitate this. Regulators have responded, mandating the development of payment rails to ensure that they keep their economies functioning and competitive by supporting digital business.

Riding the real-time rails

The emergence of instant payments is having a profound impact on the services that banks such as Citi can offer its corporate clients. To provide an example, Tony McLaughlin, Managing Director, Emerging Payments and Business Development, Treasury and Trade Solutions at Citi, cites how the bank is providing eCommerce companies in India with the ability to use a non-card collection method. The solution leverages India’s Unified Payment Interface (UPI) and enables eCommerce companies to pull cash directly from their customer’s bank accounts in real-time using a tokenised address, such as an email address or phone number.

“This is a powerful tool for eCommerce companies in India,” says McLaughlin. “It enables them to reach an entirely new ‘un-carded’ client base. It reduces costs as they will no longer have to pay an ad valorem fee to use card rails. It also mitigates fraud and charge-back risk.”

Elsewhere, Citi is helping the new wave of digital providers to grow their businesses. It is providing them with access to faster payment rails, “reducing the friction between the bank account and the merchant, improving the user experience”. Citi is plugged into 12 faster payment schemes around the world, allowing it to offer access on a global basis to these companies.

Traditional businesses are benefiting from instant payments. Insurance companies, for instance, are using faster payment rails to credit their customers more quickly when there is a claim, removing friction when dealing with their clients. Something similar is happening in the aviation industry, where airlines are using faster payments to offer their customers refunds or compensation.

Yet despite the benefits that instant payment rails are already offering companies in certain segments, corporate usage remains minimal. McLaughlin notes that there is little benefit in paying faster for B2B businesses but this should not mean that they should ignore faster payment rails, as these do more than move money faster: they also move more data using ISO20022 XML-based messaging, which provides more scope for transfer of information as well as value.

The search for transparency and efficiency

Increasing the data flow and offering more transparency through the payments process is a core tenet of SWIFT’s global payments innovation (GPI) initiative. Launched earlier this year, GPI provides corporates with the ability to track payment status end-to-end.

“Corporates have long been calling for these characteristics, especially the ability to track and trace payments,” says McLaughlin. “This is clearly a positive development that will give our clients greater visibility and control over their payments,” he adds. The challenge though will be moving the banking industry onto GPI and gaining critical mass so that clients can have a consistent payment experience around the world.

Although a positive step, McLaughlin is calling for a more dramatic change in the industry. “Banks have always been able to provide corporates with payment notifications, using SWIFT ACK [acknowledgement] messages,” he says. “As an industry, we decided to only send messages for those payments that failed and worked in the mode of management by exception.”
The reason for this, explains McLaughlin, is because of the shortcomings of the legacy banking infrastructure. The banking industry today is built on batch processing, with long, end-of-day cycles and store-and-forward messaging on the SWIFT FIN network. “Even if we did send these ACK messages for all payments, they still wouldn’t provide corporates with the real-time information they desire.”

Indeed, McLaughlin notes that this legacy way of working dramatically limits banks’ ability to offer the services that corporates are demanding, beyond track and trace. “To upgrade our services in a meaningful way, the whole industry needs to move from batch to real-time processing. Everywhere we look, this change is occurring and banks need to act.”

Hyperconnected open banking

Linked to the move from batch processing to real-time is the transformative way that banks, corporates and clearing systems are connecting. “We are entering an age of hyperconnectivity, delivered through APIs, that facilitates real-time banking,” says McLaughlin. “Soon, every bank and every clearing system will be accessible through APIs.”

In Europe, this trend is driven by PSD2. “The banking infrastructure will be opened up to non-bank players using APIs,” he explains. “This is unleashing creativity, especially in the fintech world, and it will transform the payments landscape.”

Individuals thinking about the impact of PSD2, should look at what has happened in China. “The dominant mobile money players in China are not banks, they are technology companies that have built applications that overlay the traditional financial infrastructure,” he explains. “PSD2 in Europe will allow technology companies to do the same thing.”

Although this might seem like a threat to the banks, McLaughlin highlights that it does not have to be. “If banks focus on just being PSD2 compliant, which many are, then this could be extremely damaging for them,” he says. “What they should be thinking is what services they deliver over and above the minimum that will offer value to their clients. If they don’t, the fintechs will.”

For McLaughlin, it is about banks thinking strategically about their offerings, and exposing all these micro services to the world through APIs. McLaughlin notes how Alipay in China provides a good example of this. “It is embedded in lots of ecosystems enabling it to provide data to companies who can thereby improve their customer experience”.

In Europe, McLaughlin highlights how banks could step in and offer finance at the point of sale online. Using APIs, banks could expose their credit services to merchants, enabling them to offer their customers the ability to pay now or pay later – using bank credit – when checking out online. “Everybody wins in this example: merchants can potentially increase sales by offering finance and a seamless user experience; customers will be happy because they have options when making a purchase; and banks will be able to make money by financing the transaction.”

Corporate action

In this time of change in the payments space, there is a lot for corporates to be thinking about. “I would recommend that corporates speak to their banks about their API strategies,” says McLaughlin. “Most importantly, they should be encouraging them to work with other banks to create a standard set of APIs for the industry – this is crucial. Otherwise, multi-banked corporates will face lots of different integrations, increasing the complexity and potentially limiting the benefit that these can offer.”

Finally, McLaughlin recommends that corporates cut through all the noise around payments and focus on the developments that will really benefit their operations. “There is so much opportunity that can be unlocked in the payment industry,” he concludes. “But it is important to focus on the solutions that are solving problems and not get caught up in the noise created by those solutions looking for problems.”

The emergence of instant payment rails is just one aspect of the entire payment industry’s move from batch to real-time processing, says McLaughlin. “This is the real mega-trend.”

Do not forget blockchain

It would be remiss to talk about payments without mentioning the blockchain. At present, there are many companies looking to overhaul the existing payments ecosystem using the technology. McLaughlin says that Citi is actively exploring applications of blockchain and has supported clients such as Nasdaq who have built their own blockchain ecosystems.

“Blockchain may find its greatest application in domains where the counterparties don’t trust each other and are poor at record-keeping. This is not a description of the payments world,” says McLaughlin. “Payment systems are comprised of two elements – messaging and settlement. We are investigating whether blockchain based solutions are superior in either of these two layers, but so far results are inconclusive. Meanwhile, the real revolution is taking place in the emergence of real time payments, open banking and APIs.”

McLaughlin advises that it would be unwise to ignore blockchain as the technology is still in the early stages of development and there are several examples of foundational technologies that went through long gestation periods, such as the relational database, first invented in 1970 but only properly commercialised in 1979.