FLAVORS OF **FAST**

Country Reports

Germany

Introduction

The fifth edition of global fintech leader FIS' faster payments[1] industry report, *Flavors of Fast*, demonstrates how quickly the global payments ecosystem is evolving. When *Flavors of Fast* was first published in 2014, there were 14 live faster payment schemes in the entire world. In 2018, that number has nearly tripled. There are now 40 live faster payment schemes, five real-time schemes actively preparing for launch, and 16 more "on the radar."

Adoption of faster payments remains strong, particularly in regions that have encouraged innovation and invited third parties to use the real-time rails (the network or central infrastructure that facilitates the movement of funds) to deliver a frictionless user experience. Despite that more than half of India's population remains offline, its real-time scheme now processes nearly three million faster payments transactions each day, up from two million a day in 2017.

China now processes more than 25 million faster payments transactions a day, more than double its 2017 transaction volume. Economically significant regions like the United States (US) and Australia recently launched their first real-time schemes, and since its November 2017 launch, banks in more than 15 European countries, including Germany and the United Kingdom (UK), have gone live with the SEPA Instant Credit Transfer (SCT Inst) scheme.

Meanwhile, Hong Kong prepares to launch its faster payment rail in fall 2018, as the UK reconsiders the future of its modernized payments system and explores new frontiers of open banking.

Despite that processing speed is an inherently critical component of a real-time scheme, it's not the end game. "The proliferation of the number of schemes and adoption points to the fact that global faster payments rails are no longer an outlier, but the faster payment rail on its own is not transformative. The real value we're seeing is in the overlay services that use the rail to bring additional value for end users, banks and other parties attached to the scheme," explains Andrew Hewitt, FIS Director Payment & Data Solutions.

As regions continue to invite and encourage innovation on their real-time rails (including from providers who aren't traditionally involved in financial services) we predict that 2018 marks the start of a pivotal shift in how, why and for whom real-time rails will deliver contextual relevance, frictionless experiences and value.

In this report, we examine Germany's entrance into faster payments via the newly launched SEPA Instant Credit Transfers (SCT Inst) scheme.

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[1] Flavors of Fast Definition of a Faster Payment: Inter-bank fully electronic payment systems in which irrevocable funds are transferred from one bank account to another, and where confirmation back to the originator and receiver of the payment is available in one minute or less.

Scheme Overview

Germany operates faster payments under the SCT Inst scheme that officially went live across Europe in November 2017. SCT Inst was created by the EPC in November 2016 with the publication of a rulebook for an instant credit transfer scheme applicable throughout the Single Euro Payments Area (SEPA). The scheme aims to provide consumers and businesses with the ability to confidently make secure payments in seconds with services available 24/7, and provides the beneficiary with immediate access to funds. Banks implementing SCT Inst across Europe can choose from a number of clearing and settlement mechanisms to suit their business model.

There is some local flexibility permitted to the rules with higher payment limits (currently limited to EUR 15,000) and shorter (or longer) payment timelines; a higher maximum amount limit would make the scheme more attractive for corporations and the business community. By May 2018, after six months of operation, more than 1,000 payment service providers (PSPs) joined the SCT Inst scheme, accounting for participation by about 25 percent of all European PSPs. Fifteen countries, including 500 PSPs from Germany, had banks that have signed up and adhered to the SCT Inst scheme.

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FPII Rank

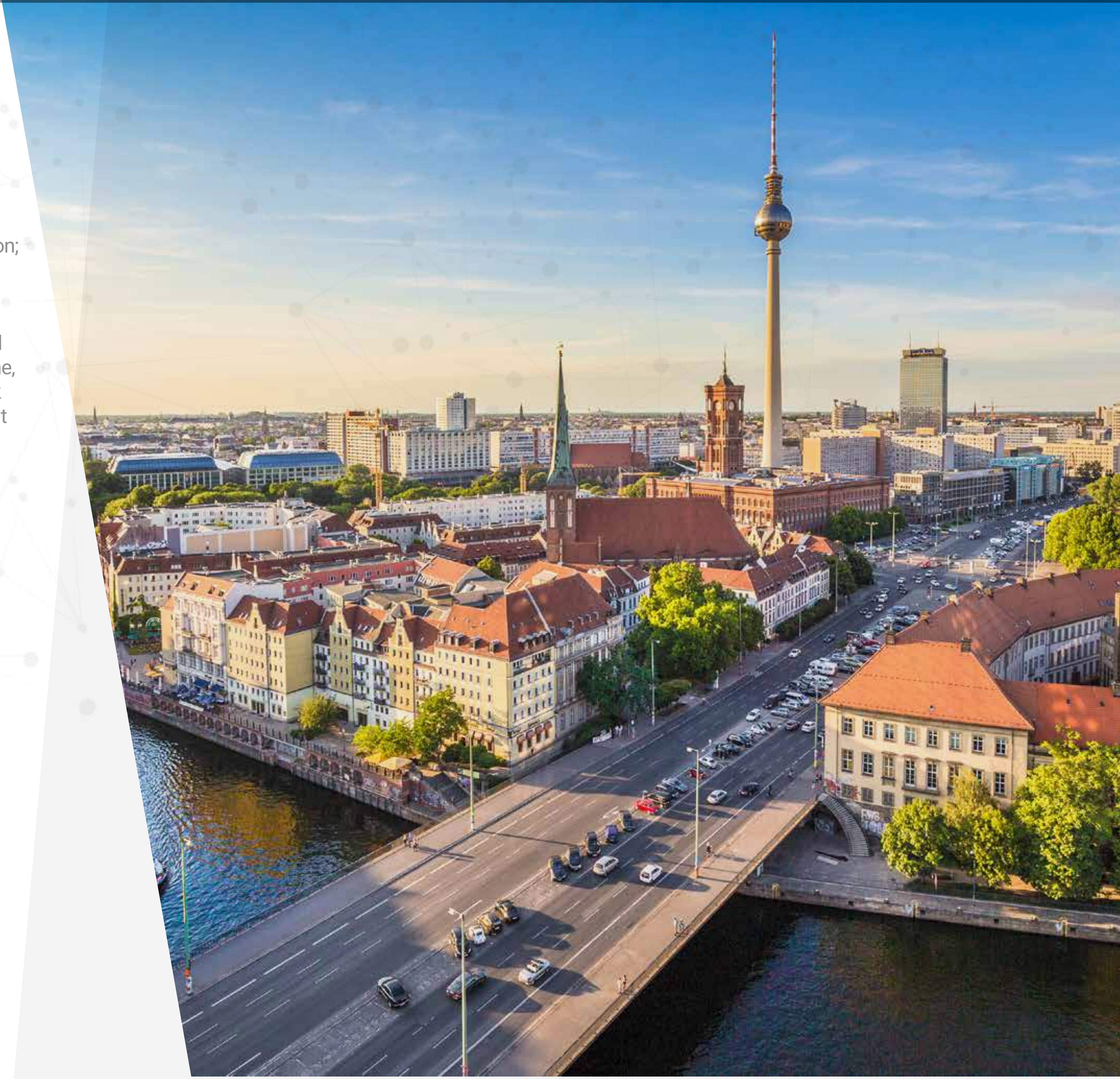
Fast Facts

- **SCT Inst launched in November 2017**
- **Achieved a 4 rating on FIS' Faster Payment Innovation Index (FPII)***
- **Operated by European Payments Council (EPC)**
- **Real-time, immediate and continuous settlement 24/7**
- **No data available on volumes and value transacted per day**
- **Supports consumer, retail, business and government payment capabilities**

* The Faster Payment Innovation Index (FPII) is FIS' five-point comparative rating system to compare and contrast diverse payment schemes. The higher the FPII score, the stronger the possibilities for innovation.

Closer Perspective

The German payments ecosystem is one of the most complex in Europe. Consequently, Germany has never been at the forefront of payment innovation; this is unlikely to change. The domestic market is highly fragmented with almost 400 savings banks and 1,500 cooperative banks collectively owning about 70 percent of the domestic deposit market. At the official launch of SCT Inst in November 2017, the majority of German PSPs had signed up and adhered to the SCT Inst rulebook. However, only one bank was live on day one, offering SCT Inst only to internal customers. The 30 million cooperative bank customers will likely have to wait until late 2018 before they can make instant payments. The savings banks (sparkassen), who hold about half of all retail deposits, collectively went live in summer 2018.



After a Slow Start…

At the launch of SCT Inst in November 2017, only UniCredit's Bank Aktiengesellschaft (known as Hypovereinsbank) was live – and only for internal account holders. The lack of a local clearing and settlement mechanism hampered widespread adoption, along with the fact that the largest banks (like Deutsche Bank, Commerzbank and DZ-bank) did not plan to offer the service until Q3 2018. Yet, in July 2018, all 385 savings banks (sparkassen) collectively went live. While this renewed interest and awareness in instant payment capabilities and could help to accelerate adoption rates, some savings bank customers were surprised (and dismayed) by the fees charged for SCT Inst transfers, at the initial launch.

The TIPS Effect

Germany's late entry into faster payments and slow adoption of them, compared to neighbors in Scandinavia, Benelux, France and others, is attributed to lack of an evident, winning clearing and settlement service. While the early adopters of SCT Inst in Germany are using the European Banking Association's (EBA) clearing mechanism through RT1, the imminent release of the TARGET Instant Payment System (TIPS) threatens to change the market – and may cause many German financial institutions to reconsider their options.

TIPS is a competing clearing and settlement mechanism (CSM) from the European Central Bank (ECB) and the member state national banks (collectively referred to as the Eurosystem); it is scheduled to launch in late 2018. TIPS extends the central bank money settlement to 24/7 availability to facilitate instant payments on TARGET2. Given the existing wide-scale participation in TARGET2, TIPS could be the public service CSM option that opens faster payments to a wider array of players.

HSBC Germany was the first to announce plans to offer instant payments on the ECB's TIPS platform beginning in November 2018. Once the TIPS service is launched, the subsequent pressure on financial institutions could accelerate consumer adoption. Until Germany's savings banks launched instant payments in July of this year, the collective awareness of real-time payments and their functionality was quite low in the country, among consumers and businesses.

The CSM market will remain highly competitive for the foreseeable future. The EBA and ECB services, along with other competing pan-European clearing and settlement mechanisms, are expected to inspire continued innovation.

> **The introduction of TIPS could prove the catalyst to increased user demand for faster payments in the country.**

Fintech Disruption

As many domestic commercial banks and international subsidiaries in Germany evaluate their position, challenger banks and fintech companies could cause further market fragmentation. Elsewhere in Europe, these disruptors have threatened to upend the local markets, though the actual impact has been less dramatic up to this point. As tech giants like Google and Apple plan to bring more mobile payment services to Germany, disruption is imminent, but adoption remains slow at present. In response, local players need to generate added value for their consumers to ensure their payment products start top of wallet, and remain there.

> **By using an ecosystem of third-party applications and services – enabled by APIs – banks can rapidly advance their digital transformation agenda in the open banking world.**

Opening-up in Germany

The shift to open banking will be as impactful to financial services providers as the emergence of online banking was in the past. Europe's second Payment Services Directive, PSD2, codifies the need for banks to open, both to increase pan-European competition in the payments industry and provide a level-playing field by harmonizing consumer protection and the rights and obligations for PSPs. Under PSD2, banks and other financial institutions must give certain licensed third parties access to account information through application programming interfaces (APIs). Once open, third-party providers can get information about an individual's accounts and balances, and initiate payments without going through the conventional payment networks.

Open APIs and instant payment mechanisms have the potential to radically change payments in Germany. By opening up German financial institutions, faster payments can be used to drive innovative use cases on a global scale. As third parties gain access to account information and payment initiation capability, a host of new product propositions could emerge.

Open banking helps customers securely and easily share data with other financial institutions, as the mobile app becomes the financial hub for every client. The result will be new marketplaces, new choices and added transparency. To do that, German financial systems must modernize the way they connect to other systems and to customers.

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