FLAVORS OF FAST

Country Reports
United Kingdom

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 what the future of fast may look like in the United Kingdom, at the ten-year anniversary of its launch of the Faster Payments Service network.

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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

When the UK Faster Payments system launched in 2008, it was one of the first bespoke instant payment services in the world, and the first payments service to be introduced in the UK in more than 20 years. Under the scheme, all phone, internet and standing order payments move quickly and securely, almost at the touch of a button, 24/7. There is currently a limit of GBP 250,000 per transaction (up from the original GBP 15,000), but the scheme is looking to increase this dramatically, to include business and treasury payments, rivaling real-time global settlement (RTGS) systems.

To provide faster payments, banks and other payment service providers (PSP) need to gain direct access to the central infrastructure; more than 20 traditional financial institutions and a few fintechs and non-banks have made the investment necessary to do so. A number of the connected banks also offer a traditional sponsor service which allows smaller PSPs to interface with UK Faster Payments. While more than 400 indirect participants use this service, it does not guarantee that every payment will transact in real time, or assure 24/7 availability.

Going forward, UK Faster Payments aims to provide a third option that will connect smaller PSPs to a technical aggregator to create economies of scale while guaranteeing real-time payments, 24/7, at a lower transaction cost. Known as the New Access Model, it could drive new, competitive and sustainable market innovation, and help challenger banks build a business case for faster payments. In parallel, the Bank of England has relaxed the rules on account settlement and the prefunded-settlement model, so there is no shared settlement risk between individual participants should a participant struggle to meet its settlement obligations.

* 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.

Fast Facts

- **UK Faster Payments launched in 2008**
- **Achieved a "4" rating on FIS' Faster Payment Innovation Index (FPII)***
- **Operated by Faster Payments Scheme Ltd. with central bank settlement**
- **Real-time, immediate and continuous settlement 24/7**
- **Over 7 million transactions daily, transferring over GBP 4 billion every day**
- **Supports consumer, retail, business and government payment capabilities**

Closer Perspective

At the 10-year anniversary of the launch of the Faster Payments Service network, real-time payments have become a prerequisite for any core current account or payment account offering in the UK.

In addition to the development of the Faster Payments network itself, the market has seen PSPs develop evolutionary products for merchants and consumers that are dependent on the network. This trend will continue as the UK's open banking ethos evolves over the next decade. Though UK Faster Payments covers many use cases, from simple person-to-person (P2P) services like splitting a restaurant bill, to small micro-business payments for tradesmen, to full corporate payment services, the broader goal is to promote the development of overlay services that rely on the faster payment rails. This will inevitably put more pressure on the legacy banking infrastructure to modernize, as better use of real-time data cross-referenced with other external data sources will support the relevant, personalized experiences that real-time functionality can offer. As the payments landscape develops in the new post-PSD2 world, the number of services offered by third-party providers (TPP) will multiply, increasing competition and fueling continued innovation.

> **Consumer appetite coupled with acknowledgment from the regulator and providers that security is paramount will drive rapid uptake of TPP services, once trust of non-bank PSPs is established.**

Blueprint for Reinvention

Compliance demands are evolving constantly with the prescriptive open banking regulations such as European Banking Authority's Regulatory Technical Standards on Strong Customer Authentication (SCA) and Secure Open Standards of Communication (SCS) directive, coming in September 2019. To maintain its innovative and industry-leading position, the UK launched a complete overhaul of the UK Faster Payments strategy in 2017.

The Blueprint for the Future of UK Faster Payments maps out the road ahead for a deep renovation of the UK payments industry, including a New Payments Architecture (NPA), a new scheme operator, new access models and new participants. The new payments infrastructure will handle the processing of all payments that currently go through the retail payment schemes – Bacs, credit clearing, Faster Payments and a new check image clearing system – bringing them under a single instant payment mechanism.

It is no coincidence that the publication of the Blueprint coincided with the beginning of a new era of open banking heralded by Europe's PSD2 regulatory changes. The vision is to create a genuinely open framework for payments to bring new services to market faster, and build real value for users around the core transactions. It seeks to change the way innovation is delivered in the UK, and NPA will be fully based on ISO 20022.

The NPA will also include adoption of overlay services like Request to Pay, Assurance Data and Enhanced Data.
The NPA will see Faster Payments become the first scheme to migrate to the new architecture in 2021. Consolidating Bacs, Faster Payments, and check and credit clearing to one technical infrastructure should reduce running costs, while the layered architecture will make it easier to introduce new overlay services and payment types, and encourage competition within the layers.

Faster Payments = Faster Economy

As international open banking schemes standardize, cross-border trade and the payments that underpin them, can be greatly simplified. UK firms will be able to make instant euro transactions as easily and efficiently as domestic payments, reducing the complexity of international trade and commerce. The removal of such barriers become increasingly significant given the uncertainties over Brexit, and how it will impact trade.

An economy fueled by instant payments encourages wider economic development and a growth in ancillary services. By directly interfacing into banking systems through open banking APIs, businesses can pay invoices directly, and instantly. Cash-flow issues and the inherent risk positions businesses can be exposed to are reduced as invoices are paid instantly.

The wholesale reinvention of UK Faster Payments promises to deliver strong growth beyond financial services, as many diverse industry sectors will benefit from a more open banking environment coupled with real-time payments.

Brexit Ambiguity

Since the June 2016 UK referendum on EU membership triggered Article 50, the international ramifications that Brexit will have on the UK financial services market remain unclear. Much of the financial regulation applicable to the payments industry in the UK today is derived from EU legislation – an important factor in the UK payments system, and the options it provides for users. This makes negotiating an exit from the EU particularly important from a payments perspective.

While UK and European banks try to prepare for potential disruption, they have one hand tied behind their back: What "flavor" of Brexit will result? Will UK companies be deterred from doing business in the Eurozone and SEPA markets? How much of an impact will a "no deal" scenario have on cross-border real-time payments between the UK and the wider euro market? Such an outcome could have short-medium term consequences for UK PSPs seeking to facilitate transactions within the euro market.

> **As many UK financial institutions have been early adopters of the SEPA Instant Payment credit transfer scheme, the ongoing Brexit negotiations may push the European Payments Council to assess individual applications from UK PSPs.**

We know that PSD2 (the second EU payments services directive) will be in place before the UK exits the EU. After Brexit, however, it's possible that only some of the legal provisions and protections in PSD2 would apply. Brexit could have ramifications on how payments (in sterling, euro and other currencies) will be treated, and impact what rights and obligations customers and UK PSPs will have. However, it is also possible that Britain's domestic payment schemes could have greater freedom to define their own rules in the future. The possibility of losing automatic qualification for SEPA would oblige the use of alternative mechanisms to make euro payments to and from the UK, and have potential implications for the continued growth of UK-EU trade. Though UK retail and corporate customers would continue to be able to send and receive euro-denominated transactions, the fees and settlement times could be less favorable than those that exist today.

Contactless and Open

The UK is now one of the leading users of contactless payments. The majority of UK adults have made a contactless purchase in the last 12 months and it's the preferred payment method for purchases under GBP 30, for three quarters of contactless users. This trend is likely to continue as more devices are connected and the Internet of Things becomes more ubiquitous.

Though apps of traditional banks remain the most used for financial services despite predictions that new entrant disruptors would swamp the market with the launch of open banking services early in 2018, legacy banking infrastructures will face mounting pressure to modernize. As the world of open banking comes online and demand for overlay services that rely on fast payment rails increases, modernization will not be optional; it will be a requirement to remain relevant.

Given the massive amounts of consumer transactional and behavioral data that comes with an open banking ecosystem, there will be a consequential growth in the demand for personalized services that better tailor products and services to customers, in real time. Fintechs were predicted to be the first movers, but UK customer loyalty to traditional institutions may be stifling innovation. Eventually, as instant payments become more tightly-coupled with open banking capabilities, UK consumers will increasingly move to the service providers that offer what they need – whether that's a mainstream bank, or a non-bank fintech or PSP.

Speeding-up Security

Security and fraud prevention remain paramount to consumers and financial institutions. Consequently, many UK banks are introducing additional fraud prevention measures for online payments, such as one-time passcodes and biometric identification, which could eventually replace current solutions like VbyV and SecureCode. Such measures are a pre-emptive strike in preparation for the open banking regulations like European Banking Authority's Regulatory Technical Standards on Strong Customer Authentication (SCA) and Secure Open Standards of Communication (SCS) directive – coming in September 2019. However, uncertainty surrounding Brexit and subsequent compliance needs for EU regulation have contributed to inconsistent security and fraud measures.

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