

# INSTANT PAYMENTS: GENERATION TWO

Second-generation instant payment systems are beginning to emerge in regions that were early adopters of first-generation instant payments, such as the Nordics and UK. What can we learn from these countries' experiences with first-generation systems, and what can we expect as we move forward with the next generation of instant payments? This paper explores both questions.

Before examining lessons learned, however, it is important to highlight the success of first-generation instant payment schemes. All have experienced significant growth in transaction volumes from the time of their launch. For example, since Faster Payments in the UK launched in 2008, volumes have consistently grown from 20 million a month within the first 9 months to more than 200 million a month in May 2019. Launched in 2012, the BiR instant payments scheme in Sweden likewise has experienced consistent transaction volume increases, including a 40% increase in January 2019 year over year.

## Lessons learned

**Standards:** Early instant payment adopters did not have any standards to follow, but acted quickly to develop something that would work. Because instant payments was a regulated change in the UK, the only pragmatic choice to meet tight implementation timescales was to use a card switch as the central processing hub for faster payments based on the fixed format ISO8583 card messaging standard. Now all new systems are moving ahead based on the XML-based ISO20022 standard. This is important to enable interoperability, achieve commoditization, and to support the development and use of API-driven components like overlay services across multiple regions.



**Regulated introduction:** The greatest success stories have come from markets where a payments regulator or government drives the introduction of instant payments. Regulated change means that all major players in the region become participants and reachable for payments. As has been demonstrated many times in the payments market, ubiquity and reachability are prerequisites for success. Broader than that, if a consumer has a bad experience once or twice they may try a third time. After that, they will move to a different channel or option. To gain maximum benefits, all players in the region or country should become participants within a given timeframe.

**Zero transaction costs:** In both the Nordics and UK, the cost of instant payment transactions for consumers has been zero. Consumers expect instant payments to be free, unless they become part of an overlay service. Although counterintuitive, there are benefits to banks too. These include a reduction in the number of transactions on more costly channels and the ability to “turn off” old channels and technology, making their operations more cost-effective.

**Transaction growth:** As noted, transaction growth in countries with regulated introductions and therefore full reachability have been very successful. In many instances, the growth has exceeded original expectations. Therefore, it is important to ensure that, whenever building or implementing solutions, flexible scalability is a critical consideration.

**Fraud and AML:** Fraud constantly evolves. When countries introduce instant payments, unfortunately there are always weaknesses for fraudsters to exploit. Depending on the country of implementation, different issues can arise. For example, when a payer sets up a new payee in the UK or changes the account information on a payee, they cannot always be sure the account they are working with is actually the target recipient's account. Therefore, if you receive the wrong details, fraudulently or by mistake, once the transaction processes (assuming it is a valid account), the money is transferred, and the transfer is irrevocable.



In the UK, a new system is coming to market in 2019 that will address this problem. A “look up” feature will confirm if the name entered matches the actual name on the account. The payer can then check the details and either accept the details, execute the payment or abort the transaction.

In Sweden, this is not an issue, as accounts link to a digital ID. Therefore, when implementing new systems, it is important to review fraud possibilities to minimize the risk of fraud.

Additionally instant payments can lead to instant fraud and instant money laundering. Transaction monitoring and sanction list scanning has to be done within a lifespan of seconds rather in hours or days of the past.

## What can we expect with generation two instant architectures?

Initial designs for the new pan-Nordic system called P27 and the New Payments Architecture (NPA) in the UK suggest that these next-generation infrastructures will support not just instant payments, but also replace low-value batch solutions. Both will follow the ISO20022 standard for messages and are likely to have a tiered architecture specifically designed to aid the introduction of new overlay services and encourage third-party access.

As open banking emerges and begins to gain traction, more third parties are coming to market with new concepts and applications that can provide innovative services using customer consent data. These may use an embedded payment processed through the instant payments channel. Currently, many of these applications can use only card processing for payment. However, card processing is expensive and, when margins are tight, this is something that developers are keen to avoid. These payments are often referred to as frictionless or invisible payments.

One overlay service gaining interest already and likely to come to market before the next-generation architectures go live is request to pay. This service enables the payee to contact the payer with a bill or invoice and the payee to accept and transfer the funds, partially pay, reject or request further information. Request to pay will enable more business to migrate to the instant payments channel.

Another advantage of second-generation systems is that they improve the ease of transacting, speeding up doing business, carry more data, allow 'track and trace', lowering costs and ultimately increasing GDP in the country or region.

## Conclusion

The world is moving rapidly towards instant payments generation two. For banks to replace lost revenue from traditional payments, they should look to new value-added services, such as the overlay services mentioned above, and consider carefully how to build their architectures to ensure that new instant payments systems are both flexible and truly scalable to support future growth.



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