





# Foreword

When the Office of Fair Trading asked the UK banking industry to remove float from standing orders, it did not expect the industry to opt for a real-time solution, and the industry did not fully anticipate the implications of the undertaking. The technological, operational and risk management implications of providing payments in near real-time fundamentally change the user experience, as well as the inherent operational risk profile. The implications will continue to unfold for many years to come.

People define innovation differently: sometimes in terms of a process and sometimes in terms of an outcome. However you define it, the significance of many innovations often only becomes apparent with time. It is also the case that things which make an innovation significant can be unexpected or unintended at the outset. This may well be the case with the Faster Payments Service. Looking forward, it is easy to imagine that the introduction of the service may become regarded as an innovatory milestone that changed the nature of payments. Like a Faster Payment itself, this milestone is irrevocable and is changing the expectation of the global marketplace.

Some banks are addressing the need to reinvent their business and operating models in order to benefit fully from the scheme's capabilities, whilst others are adopting a more conservative approach. Like innovation, the effectiveness of any given strategy is always finally judged in hindsight. Global trends that shape the payments market all point to making greater use of real-time processing. So, whether you are a strategic visionary, a fast follower or are in a 'wait and see' mode, you need to have a clear position on Faster Payments and the key issues it presents.

We hope that you enjoy reading this report, that you find it informative and that it provokes you to see the initiative in a new light. The Faster Payments Service might have its genesis in regulatory pressure, but it is customers who will demand it, and payment service providers who will unlock its potential.

VocaLink and PricewaterhouseCoopers LLP UK would like to acknowledge the contributions and support from the UK banking industry, The Payments Council, UK Payments Administration Ltd and the Office of Fair Trading. Their comments have been frank and constructive and they have all been very much appreciated.



**Martin Wilson**

Chief Commercial Officer  
VocaLink



**Julian Wakeham**

Partner  
PricewaterhouseCoopers LLP UK



# Contents

|  |    |
|--|----|
| Preface  | 1  |
| Executive summary                              | 3  |
| Real-time payments: key to the future          | 9  |
| The payment service provider (bank) experience | 13 |
| The payment service user (customer) experience | 27 |
| Unlocking the value                            | 31 |
| Conclusions                                    | 45 |
| Appendices                                     | 47 |



# Preface

## **The Faster Payments Service - introduction**

The Faster Payments Service (FPS) of the CHAPS Clearing Company passed a major milestone in its evolution by completing its first full year of operation in May 2009. It is becoming a fundamental part of the UK payment infrastructure, efficiently processing 180 million transactions and safely moving £70 billion<sup>1</sup> of customer money during the period. The new service now reaches 80% of UK bank branches. The future has happened, FPS has long passed the point of no return and addresses the original reach expectations of both the industry and Office of Fair Trading.

The Faster Payments Service uses real-time technology and operations to bring an instantaneous online payment experience to customers. The service sets the standard for customer propositions around the world, providing a modern proposition as well as speeding up the existing standing order process. The core features of the Faster Payments Service include:

- 24/7 operation
- Immediate delivery
- Immediate confirmation
- Irrevocability
- End-to-end, straight-through processing.

## **Report context**

In 2008, VocaLink modelled the potential benefits and economics of implementing a

Faster Payments Service in other countries including Australia and Belgium<sup>2</sup>.

In 2009, VocaLink in association with PricewaterhouseCoopers LLP UK now take the opportunity to consider those expectations in the light of an operational service in the UK.

This report:

- Examines the status of the change one year on and anticipates how the story might unfold in the years ahead
- Exposes the reasons why banks are approaching it with different levels of confidence
- Anticipates how banks will leverage and profit from it going forward.

Furthermore, we seek to understand how banks can:

- Leverage their core transaction banking capabilities to generate attractive new propositions for customers
- Create new revenue streams in the future.

Throughout this report there are a number of customer value proposition examples. These serve to highlight the potential opportunities to generate future revenues.

<sup>1</sup> CHAPSCo Press Release, 26 May 2009

<sup>2</sup> Economic advantages of real-time payments in Australia and Belgium, CEBR/VocaLink, 2008

This is particularly important for banks, given the malign market conditions into which the new service has been pitched. As the service matures, the business case for its future development becomes more evident, so banks must explore ways that compelling new commercial propositions can be created.

**Discerning fact from fable -  
a practitioner's view**

This is the first study of the Faster Payments Service to probe the practitioner experience in detail.

In undertaking this study, we have confronted a number of perceptions that have rightly or

wrongly grown up around the Faster Payments Service. Some perceptions emanate from the teething problems and difficulties of implementing any new system, whereas others reflect the knock-on effects that the service is having on related payment processes.

This report challenges these perceptions and establishes the facts behind them; it differentiates the reality from the 'myth'. It aims to give valuable insights into how the service will develop in the future and highlights a number of pitfalls to avoid.

Readers may be surprised by the outcome.

# Executive summary

We live in a real-time and interconnected world where customer tastes change with enormous rapidity. Bank customers expect a real-time experience from their banks, one that is highly integrated into their increasingly digital lives, and one that can adapt quickly to their evolving needs and wants.

In conducting our research, we found that the design and implementation of Faster Payments has left some issues that require further attention but the operation of the scheme and infrastructure have been a success. More work needs to be done soon to move the agenda forward and leverage the investments made.

---

Banks need to rise to the challenge and contemplate what might have once seemed unthinkable

---

Several major forces are combining to raise the price of being in the payments business and to limit the level of discretionary scope in what must be actually provided by banks:

- **The Payment Services Directive (PSD)** is reducing barriers to market entry, as well as to traditional clearings. It removes many of the information asymmetries that exist between banks and their customers: it requires faster payment clearing, and establishes obligations

that will require real-time processing. Banks have to beware.

- **The Single Euro Payments Area (SEPA)** is displacing national schemes with new 'SEPA schemes', rationalising the clearing and settlement marketplace and changing the necessary economics of scale. Banks have to reorganise.
- **Regulation** is continuing to generate operational change and to further the vision of the single market. This is shifting liability from consumers to banks and increasing the demands for new investment while reducing price variations to the level of the cheapest. Banks need to innovate.
- **Technology** is changing the terms and basis on which customers are willing to interact with each other as well as their banks. 3G has arrived. Internet 2.0 has arrived. Social networking has become the norm. Banks have to adapt.
- **Globalisation** continues to affect all parts of the supply chain with customers wanting a common platform and consistent interfaces in every country in which they operate. Global standards are displacing national standards and open standards are displacing proprietary standards. Banks need to respond.
- **Liquidity** has jumped up the agenda, both in terms of ensuring that sufficient liquidity is commercially obtained, as well as ensuring that the consumption of collateral to create payment liquidity is optimised. Banks have to optimise their settlement risk management.

## **Faster Payments has arrived - the future happened yesterday**

Faster Payments steps into this maelstrom as a voluntary UK payments service that provides customers with the ability to effect irrevocable real-time electronic payments from internet and telephone banking channels. This can be done any day of the week and at any time of the day, with confirmations also provided in real time.

Faster Payments was instigated by the Office of Fair Trading (OFT), designed by banks, implemented by VocaLink and managed by CHAPS Co Ltd. It successfully passed its first anniversary in May 2009, processing over 180 million transactions in this period. Its second year will easily exceed this.

These figures will grow substantially over time and, with a fair wind, may exceed 2.5 billion transactions per annum by 2018. Volume will come from a variety of sources, both retail and corporate. The market is also likely to see significant migration from other instruments, as the capabilities of the Faster Payments Service are leveraged and further innovated.

Innovation will be spurred on by the PSD. Entrepreneurial banks and companies with agile and focused business capabilities will soon obtain access to the Faster Payments network. The reach it provides will enable them to offer compelling products to the market. Some of these will be genuinely new, but others will compete head on with banks.

Banks with outmoded operational processes and technology platforms will be deprived of their traditional competitive advantages of reach and clearing. They may therefore find that the recent acute financial crisis has only heralded a more chronic financial crisis in years to come.

### **Key lessons and findings**

#### **Faster Payments has received no complaints**

100% of interviewed participants reported no issues with the Faster Payments Service itself.

One bank had no customer complaints and most reported remarkably few.

Overall we found that the complaints that had been received were either:

- Questions about the proposition itself. In particular, why a particular beneficiary was not reachable by the service.
- Dissatisfaction with the differences between the system and their expectations based on previous systems. For example, some customers that were unaware of the irrevocable nature of the proposition had addressed payments incorrectly, but to a valid account, and found that the bank was unable to stop the payment or recover funds for them from the beneficiary.
- An issue that is associated with the Faster Payments Service but is actually pertaining to another of the bank's processing systems. This occurs where the underlying incident is experienced, highlighted or exacerbated by the use of the Faster Payments Service, e.g. the unavailability of online banking.

#### **There is plenty of scope to create new revenues**

Two-thirds of banks interviewed were very positive that Faster Payments could deliver new revenue streams, with potential revenues identified in the business-to-consumer segment reaching £2.9 billion by 2018 and £1.9 billion in the business-to-business space.

There is no doubt that Faster Payments will also displace revenues from other sources of income, such as CHAPS, but this needs to be seen in the total context of displacing the costs of cheques and reducing the costs of cash. With effective strategy, product development and delivery, Faster Payments will have a net benefit for the banking industry and positive benefits for customers.

#### **Faster Payments helps the payments business into the 21st century**

Some banks have been much less willing to operate a real-time payments service than others because of the scope of the necessary changes

required to their underlying systems. Faster Payments is not just about a 24/7 processing system, but also all of the related management, operational and support processes that now also have to be 24/7. If an incident occurs and relates to Faster Payments, it is now immediately visible to the market in a way that was not necessarily the case with Bacs.

Banks that had invested in modern real-time accounting systems were therefore much more able to implement and operate Faster Payments than their counterparts, particularly where these were still relying on legacy and batch-based systems.

An unintended benefit of Faster Payments has therefore been to up the ante for banks, helping them into the 21st century and providing the incentive for them to 're-architect' their transaction banking platforms. The scale of the cost of compliance has consequently differed dramatically between the leaders and the laggards: in some cases by nearly 100 times.

### **Faster Payments can increase operational risk, but only if you let it**

There is a common perception in the market that Faster Payments is "too risky".

All of the interviewees for this report were very clear about the risks inherent in an irrevocable real-time proposition and one that has some settlement risk attached to it. Respondents were also very clear that the extent to which this is an issue depends on how effective the risk management processes are, and also how well the respective controls are operated. The message was equally clear: no-one need fear Faster Payments if they are on top of risk and control processes.

Faster Payments has attracted the attention of some organised criminals probing to see if they can gain from design or control problems around the online banking channel. Change means opportunity for fraudsters whilst an increased threat profile is typical of any new implementation. An effective control

environment is therefore essential, but it will only be as strong as the weakest part: banks must re-examine all aspects of their supply chain and operating models.

Risk management and security are seen by some as competitive differentiators, whereas for others it is regarded as a collaborative issue. The profit motive and bank reputation are important incentives for driving down risk, provided that the integrity of the scheme is not undermined.

A number of lessons have been learned and the industry remains vigilant. However, there does appear to be scope for more collaboration on these matters between banks.

### **A missed opportunity**

The decisions to extend the required proposition beyond standing order float and then to launch the scheme to customers at no cost, appears to be a missed opportunity for banks. It is also one that is now very hard to recover.

We understand pricing sensitivities for banks, but do not agree that retail customers will not pay for payments: receipt fees, credit card surcharging, service charges for mobile payments and the experience of other industries all indicate a willingness to pay. The key thing is that where customers do pay, they pay for perceived value, and that prices are fair.

We believe that if the introduction of a real-time urgent payment proposition, with associated confirmations, was of sufficient value that customers would have paid for it if asked. This would not have applied to standing orders, but nor would it have needed to.

What is important now is that scope for commercialising future extensions to the service - driven by limit increases or value adds - are not missed.

### **The time of the mobile-initiated electronic payment is finally arriving**

After many false dawns, mobile phones have passed the tipping point and can now deliver

their promise of content-rich applications with high speed point-to-point communication.

Smart phones are rewriting the mobile telephony rules, providing easy to use real-time voice and data exchange. The universal utility delivered by the mobile phone needs an equivalent payments standard to unlock the potential of real-time point-to-point electronic payment. Faster Payments appears to provide an answer.

With the UK payment industry's commitment to displace cash and to discontinue cheques, a viable alternative is needed in all of those paying moments where people currently have a real-time payment experience, many formerly satisfied with cash. The mobile can be that answer, but this places an even greater need for 100% reach as a vital final step for banks.

### **100% reach is important in the payments business**

The assumption that the scheme could be launched and be unequivocally successful based on the existing membership appears overstated. Whilst the proportion of addressable sort codes within the existing scheme participants is high, the gap between that level and universality introduces difficulty in promoting the service. Even in some 'compliant' banks, sort codes are not reachable.

Customers wish to make fast payments easily and without issue, but instead they can be confronted by a confusing situation whereby the proposition is uncertain. A payment will only be real time if the beneficiary account can be reached. At present a significant number cannot be. As a result, banks are hampered in proactively marketing the service because it is such a conditional proposition. This has created a number of problems:

- 67% of consumers are unaware of the Faster Payments Service, and some of those that are aware are either confused by what they know or have an incomplete knowledge about it
- In Northern Ireland, Faster Payments are difficult

to promote due to local banking communities' level of participation within the Faster Payments scheme, adversely affecting reach

- Banks are unable to proactively market the service because they cannot market such a conditional proposition.

### **Courage and commercial focus is needed going forward**

In assessing the implications of these findings, banks need to be courageous. In some cases, they will have to 'think the unthinkable' when considering the issues raised by this report and the questions that then follow:

- Have the threats been fully catered for in the strategic payments planning process, with appropriate assumptions made and necessary actions agreed?
- What is the expected share of the projected 2.5 billion transactions and how will this be achieved? Are the product areas innovatively generating new propositions and products that are sufficiently customer centric? Does the organisation have the necessary skills and experience to think like new entrants?
- Is there a migration strategy for the outmoded instruments and how will the cost base be reshaped? What is the organisation's real-time strategy and how will customer experience be aligned with new operational processes? Have all of the potential implications from an operations, human resources and risk perspective been thought through? How will margins be protected?
- Have all of the direct and indirect threats and risks in relation to the service been analysed and understood? How do the implications differ from previous experience and what needs to be done differently? Are the required controls sufficiently effective and resilient?
- Is there a good story to tell around the mobile phone? Has product development truly walked in the shoes of the customer? Is the nature and role of the mobile with our customers fully understood? How will the strategy meet the emerging needs of the younger market place?
- Are the new services priced for value? Is there

confidence that new services will add value and enable differentiation of the offering between payment service providers? How will they compete?

Regulators and market makers will have different perspectives and will accordingly have different questions on their agenda:

- How does this development in the UK affect the competitiveness of the UK financial system? What lessons can be learned and how should other markets respond? What will be the role of a faster payments service in the development of a more integrated European payments landscape in general and “e-SEPA” in particular?
- What is the effect of a faster payments service on an overall market infrastructure risk profile? How does it change the underlying fraud and integrity risk? Will it become a systemically important payment system and should it be regarded as part of critical national infrastructure? If so, under what conditions?

0In the event of a crisis, how will a faster transmission mechanism that can be accessed with an unprecedented immediacy affect existing scenario plans and contingency arrangements?

- How does the establishment of a Faster Payments Service affect the infrastructure and payment instrument convergence agenda and how will it affect the experience of consumers?
- How does this type of improvement in one area of online banking affect the social exclusion agenda for those unable to access the new services?
- What are the implications for the typically national real-time gross settlement (RTGS) operators that often support urgent customer payments in addition to providing settlement services?
- If a service which provides ‘faster’ or in other ways enhanced payments is treated as a ‘free good’ for consumers how will this affect related issues such as cross-subsidisation and market incentives?



# Real-time payments: key to the future

*This section includes:*

- *The need for real-time technology;*
- *The features of the Faster Payments Service;*
- *A roadmap of the UK payments market (operational issues and strategic context).*

## **The electronic payments industry is lagging behind**

Throughout time, the pace of change has been driven by an underlying demand for convenience, speed and efficiency. These requirements remain as important today as they have always been.

In recent years, real-time, digital and point-to-point technologies have emerged as transformational forces that penetrate many spheres of modern life. They have become the dominant enabling technologies in retailing, logistics, manufacturing and many other industries. Despite these profound changes becoming a part of everyday life, the global electronic payments industry has lagged behind.

In many respects existing electronic payment models are often modernised updates of their 20th century predecessors. The technologies may be modern, but the processes remain much the same as they have always been. Batch processing, extended clearing cycles, limited customer control and opaqueness of information are all fairly characteristic of the electronic payments business.

Real-time technologies have been successfully

employed in the payments business, for example in real-time gross settlement (RTGS) processes, as well as in online card authorisation. However, in general, customers have been expected to wait, which vividly contrasts with the current experience and expectations of today's marketplace. A marketplace increasingly influenced by the 'Google generation'.

The next stage in the evolution is to apply the benefits of real-time technology to all electronic payments. This has been described by some as 'faster than cash', 'natural evolution' and an 'inevitable end-state of all electronic payments'<sup>3</sup>.

## **The UK Faster Payments Service - an ACH on steroids?**

The Faster Payments Service that was introduced on the 27th May 2008 delivers a real-time payments backbone for the UK. It addresses the regulatory pressures that provided a strong incentive for removing the float on standing orders, as well as the need to 'speed up' personal payments through Bacs.

The Faster Payments Service achieves this by linking bank accounts in real-time through a central infrastructure and with settlement being done over settlement accounts at the Bank of England. It also has the potential to connect third parties.

<sup>3</sup> VocaLink: "Real-time payments – a platform for innovation", April 2007.

One practitioner described the Faster Payments Service as an 'ACH on steroids', but this understates the nature of the service. In addition to enabling a real-time payments experience, the Faster Payments Service also involves 24/7 operations, real-time settlement risk management, customer self-service and multi-channel capabilities.

*A full description of the main Faster Payments Service features is outlined in Appendix 4.*

### **The service is experiencing 'growing pains'**

The latest statistics demonstrate that the Faster Payments Service continues to grow. As of July 2009, it has already successfully processed over 240 million transactions. Much of this volume derives primarily from payments between personal account holders, or from personal accounts to business accounts. This reflects the two channels in which it has been implemented to date: internet banking and telephone banking.

Although these figures demonstrate steady organic growth, they are lower than originally planned. Fewer banks than expected use the service. At the time of its development, the architects of the service decided not to seek an 'obligation to receive', and those banks that are operating the service have varying levels of deployment. Given the significant undertakings in capital and technology, this indicates that there is still work to do.

The inability to reach all addressable sort codes (for example, in the case of agency banks) is a major hurdle to achieving ubiquity. The current situation detracts from the power of the proposition by introducing uncertainty, and this uncertainty creates several problems:

- Customers who leave payments to the last minute can discover that the beneficiary does not bank with a participating bank, which can cause them to either pay the additional cost of making a CHAPS payment or risk the consequences of missing the relevant payment deadlines as a result
- Banks that feel prevented from marketing their

services because of the impact that making the necessary caveats would have on the customer proposition.

The implications of real-time technology and operating processes for legacy systems have been another major challenge. Banks have discovered that real-time propositions that are offered 24/7 require real-time operations and incident management. Now incidents in online payment systems are more visible and more consequential for customers. With the Faster Payments Service, customers should be able to do payments online and over the weekend, but if their electronic banking system is unavailable, they may be left with no means to make a payment for a Monday.

Whilst the service has been welcomed by the media, the slow rollout has attracted mixed reviews. Overall, there are indications of benefit but the 'jury is still out'.

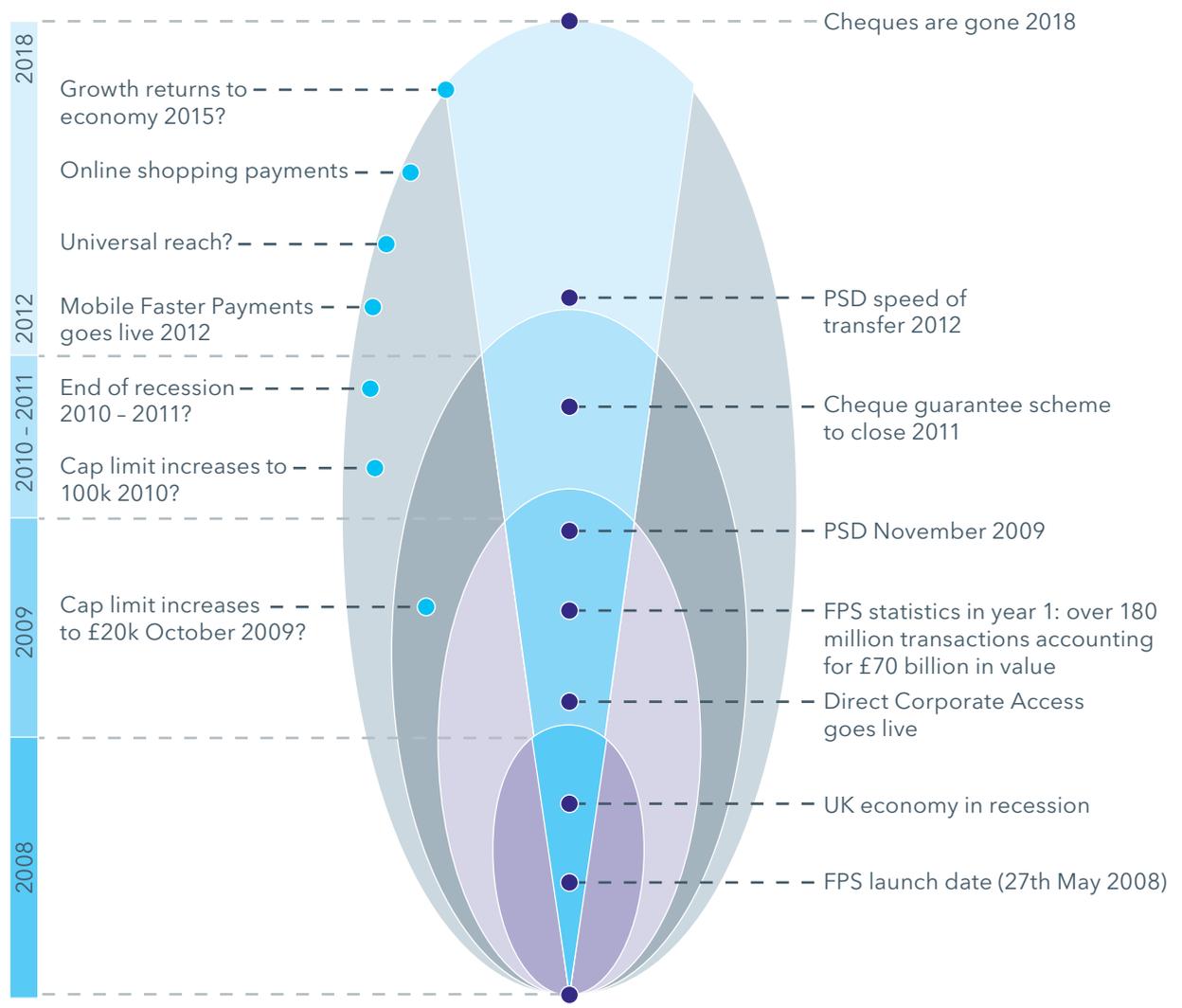
### **The Faster Payments Service has arrived at a significant moment**

*Figure 1 shows a UK payments 'change radar' for the period 2008-2018.*

The launch of the Faster Payments Service has coincided with an unprecedented world financial crisis and economic slowdown. This has forced it off the agenda of many senior executives who have been properly more concerned with preserving the continuation of their organisation's history. However, the world continues to move on and industry leaders are once again facing up to the big questions of legacy systems, risk management and revenue growth. This is, of course, a major challenge in a period of scarce capital and malign market conditions.

However, research continues to show that firms who invest in their businesses during a downturn can enjoy higher than average earnings during the subsequent upturn. Citing Audi as an example, the author of a study reported in the

**Figure 1:**  
**Radar – A perspective on future developments in the UK payments market**



**Legend**

- Key milestones
- Dependencies on the environment
- FPS = Faster Payments Service

American Banker in March 2009,<sup>4</sup> shows how the company is leveraging competitor weakness to build brand awareness and product positioning. Not only does this strategy generate results, but it is also achieved at a lower investment cost as a consequence of softer market prices.

The change radar, *Figure 1 above*, highlights a number of potential developments that will

affect the Faster Payments Service, including the PSD. The PSD reduces the barriers to entry for new entrants by creating specific licensing arrangements for Payment Institutions, but also introduces a number of specific transfer time requirements for banks. Taken together with SEPA, these issues all require a strategic response when many in the market are struggling with the 'minimum' demands of compliance.

There are, however, several organisations that are well into their investment cycles and establishing a de facto 'premier league' of

<sup>4</sup> "Firms that are able to increase advertising during recessions are likely to have stronger future earnings", research by Oregon State University and Western Oregon University.

transaction banks within the market. The foundation of much of today's market, particularly in the consumer segment, is real-time, and therefore, it is a small leap of faith to believe that the future of payments involves a real-time platform.

The next three years will therefore be crucial for the development of the Faster Payments Service. Some of the events anticipated in this timescale include further increases in limits, widening of the reach of the service to effective 'universality' and the implementation of a mobile Faster Payments Service. These events will occur against

the backdrop of declining cheque usage and migration of these volumes to other instruments, including to the Faster Payments Service.

Only once this process of change is over, will the market be able to see how the seeds sown by the OFT and nurtured by the UK payments industry through the worst recession for many years will finally bloom. However, it is clear that some organisations are focused on investing in value-added services for their clients and in support of their claims to the emerging 'premier league' of payments.

# The payment service provider (bank) experience

*This section includes:*

- A brief summary of the data gathering process;
- Key findings from the interviews;
- Some observations on potential Faster Payments use;
- A note on international replication of Faster Payments;
- HSBC case study.

## **The data gathering process**

The Faster Payments Service celebrated its first anniversary in May 2009. Although successful, it has attracted criticism from the Office of Fair Trading related to the slow up-take of the service and failure to achieve anticipated volumes. In addition, consumer groups and some industry commentators have been critical of the service for a variety of reasons, while acknowledging the real benefits to consumers.

This section of the report has been prepared on the basis of structured interviews, where interviewees were invited to rate their perspectives on a number of issues relating to the design, implementation and operation of the service as well as on a number of perceptions of the service that exist in the market. A summary of interviewees' responses is set out in Appendix 5, and the insights gained from the practitioners consulted are discussed below.

## **Findings**

Our research with bank practitioners reveals that whilst experience is not identical, some common themes are beginning to emerge around the

operational aspects, business potential, costs and risks. For those banks with greater volumes and a more commercially developed approach to the Faster Payments Service, these are clearer, whilst for others, who may have treated the Faster Payments Service as a compliance project to date, they are only now coming into focus.

## **Revenue potential**

Two-thirds of banks interviewed were very positive that the Faster Payments Service could deliver new revenues for banks, based on its unique real-time features. In one case, a bank was able to predict that the payback on its initial investment in Faster Payments was being achieved within three years, with additional revenue potential yet to be explored.

---

Several banks felt that they had 'missed a trick' in moving to zero charging

---

Generally, the scheme participants accept that simple credit transfers using the Faster Payments Service will be offered to retail customers without attracting a specific charge. They did, however, remark that this assumed that the transfers relate to standing orders, as well as fast online or telephone initiated payments under £10,000 in value. They also recognised that the current review into the bank charges may cause

# Customer value proposition – Mobile Faster Payments

## What is it?

Consumer take-up of mobile banking and mobile payment services has steadily been increasing with banks seeking to extend their online banking channel services to mobile handsets. However, Faster Payments has the potential to enhance mobile banking and payment applications through immediate payment, immediate confirmation and 24/7 availability.

## Customer need and benefit

Real-time based mobile payments address a range of customer needs related to payments, underlining its potential as a compelling consumer proposition.

- With the gradual decline in cheque usage being fuelled by an end date set by the UK payments industry, there will be a need to provide an alternative person-to-person, person-to-business payments method
- Some customers do not like to carry cash around and are inconvenienced when they are required to pay by cash. Real-time based mobile payment services can potentially be used for lower value payments, and therefore, to reduce the need to carry cash; people do not mind carrying mobile phones, and using these devices for payments helps to lower their need for cash
- Customer expectations related to financial transactions arguably continue to increase with payment industry representatives also acknowledging this: "Consumers expect to be able to conduct business when they want, how they want and where they want. They also want to do everything that they used to do inside their local branch quickly, easily, securely – and remotely"
- People tend to prefer cash as a payment option when it comes to buying from, or selling goods to, someone where an environment of trust is yet to be established. For example, when buying a second-hand motor vehicle from a web-site or publication. By routing mobile transactions through Faster Payments, the proposition becomes a closer substitute to cash; since payment and confirmation is done immediately, there is no need for a position of trust to be established before the transaction.

## Paying moments

There are number of different situations in which mobile payments would provide an effective proposition and would assist in the displacement of traditional payment methods, especially cheques. Some of the paying moments would include:

- Person-to-person payments – within the UK there are approximately 748 million cash payments and 114m cheque payments\*
- A large majority of these are payments to friends and family
- Person-to-business payments – within the UK there approximately 750 million cash payments and 158 million cheque payments\*

A large majority of these are payments to small businesses providing services and goods.

\* Source: UK Consumer Payments 2008 (Payments Council)

them to rethink this assumption depending on its outcome.

Several interviewees believed that the industry had 'missed a trick' in moving to zero charging. Others perceived that this decision was inevitable given the precedent of Bacs and that it was justified in terms of improving customer experience, as well as for maintaining the perception of the bank.

However, several banks identified the potential to deliver revenues for value added services from retail customers as the service evolves.

These could arise from:

- Making higher-value urgent payments – for example, using the relaxation of the £10,000 limit to introduce tiered charging for higher values
- Current account banking moving to a chargeable basis with payments forming part of the package. One interviewee commented that "Free in-credit banking won't be around in 3 years' time –including payments"
- Providing the service through new channels, such as mobile
- Integrating the service with consumption, fiscal or investment processes, such as buying a house or paying taxes.

Banks were generally more positive about the potential for revenues from corporate than from retail customers. Charging for payments is the norm in this sector, and revenues can be achieved in the short to medium term without significant additional infrastructure expenditure beyond the already delivered features of the Faster Payments Service. This revenue is being generated by addressing those customers for whom the service complements or enables a customer proposition:

- **Immediate payments:** businesses that will benefit from being able to pay immediately as a key feature of their product offer, for example, those offering immediate consumer credit facilities, where an immediate credit decision can be backed up with immediate delivery of funds with a range of applications

from 'payday' loans to car purchases. A similar facility can also be used by insurance companies and others who feature immediate emergency payouts as a benefit to their customers, and need to guarantee delivery of funds. For such purposes, the Faster Payments Service is a superior offer to CHAPS in many ways, and is being offered at a price point that is creating new opportunity rather than merely substituting payments away from existing instruments.

- **Direct Corporate Access (DCA) service:** banks may deliver an easy way to extend more rapid services to customers that wish to speed up certain payments. This saves investing in the changes necessary to support all the real-time aspects of the Faster Payments Service. This service is more like a 'fast Bacs' in operation, accepting batched payments in the traditional Standard 18 format. As this service only became available in March 2009, its roll-out is in its early stages but we were told 'banks are waking up to DCA'.
- **Immediate collections:** banks offer their corporate customers information in fast batch or real-time to identify customers who have cleared bills via the Faster Payments Service, enabling organisations such as credit card companies to guarantee that payments made by their customers to collection accounts on the due day will be credited on that day. Such services can deliver immediate benefits in both differentiating the customer proposition and reducing reconciliation costs.

## Implementation

The cost of implementing the Faster Payments Service is still fresh in the memory of those banks surveyed. In most banks, implementation was regarded as a compliance project, and as such it was treated primarily on a cost management basis rather than a benefits realisation basis. Consequently, this has led some banks to write off the cost of development rather than subject it to ongoing scrutiny as if it were a commercially driven project.

## Customer value proposition – Insurance

Within the insurance industry there are a number of areas where the Faster Payments technology can make a significant impact. The immediate internal areas where benefits can be realised, reside within the Accounts departments – accounts receivables, cash management, and reconciliation of claims or premiums. The capabilities of the Faster Payments Service can deliver efficiencies; reduce overheads and complexities of incoming and outgoing payments.

Current traction within the 'Pay Day' loans marketplace highlights the potential benefits of being able to make a loan application and to receive the loan payment within hours. Relating this to claim payments, insurance customers could be paid for their claim within hours of sending through the required forms. This would be particularly compelling for emergency payments to claimants as a result of property, casualty, motor or personal claims. This could provide a unique selling point for insurance companies with regards to customer or client recruitment.

Reported costs to implement even when adjusted for volumes, vary significantly. While this was not a surprise, the order of magnitude of variation was very significant. One bank claims to have delivered the Faster Payments Service within a budget of hundreds of thousands rather than tens of millions (GBP). Banks that reported lower implementation costs named a number of factors that contributed to this:

- Having a clear payments strategy aligned to business need
- Established real-time payment and accounting operations
- Rationalised infrastructure and optimised processes
- Access to skilled resources and optimised sourcing models
- Clear segregation of the Faster Payments Service implementation from other work.

Care must be taken when considering these findings. Those banks whose implementation costs were at the higher end of the range were typically addressing a project with a much wider scope than the Faster Payments Service. For these banks, their implementation necessitated the drawing forward of plans for such things as the rationalisation of payments infrastructure and the enablement of real-time accounting. While the cost was not fully attributable to the

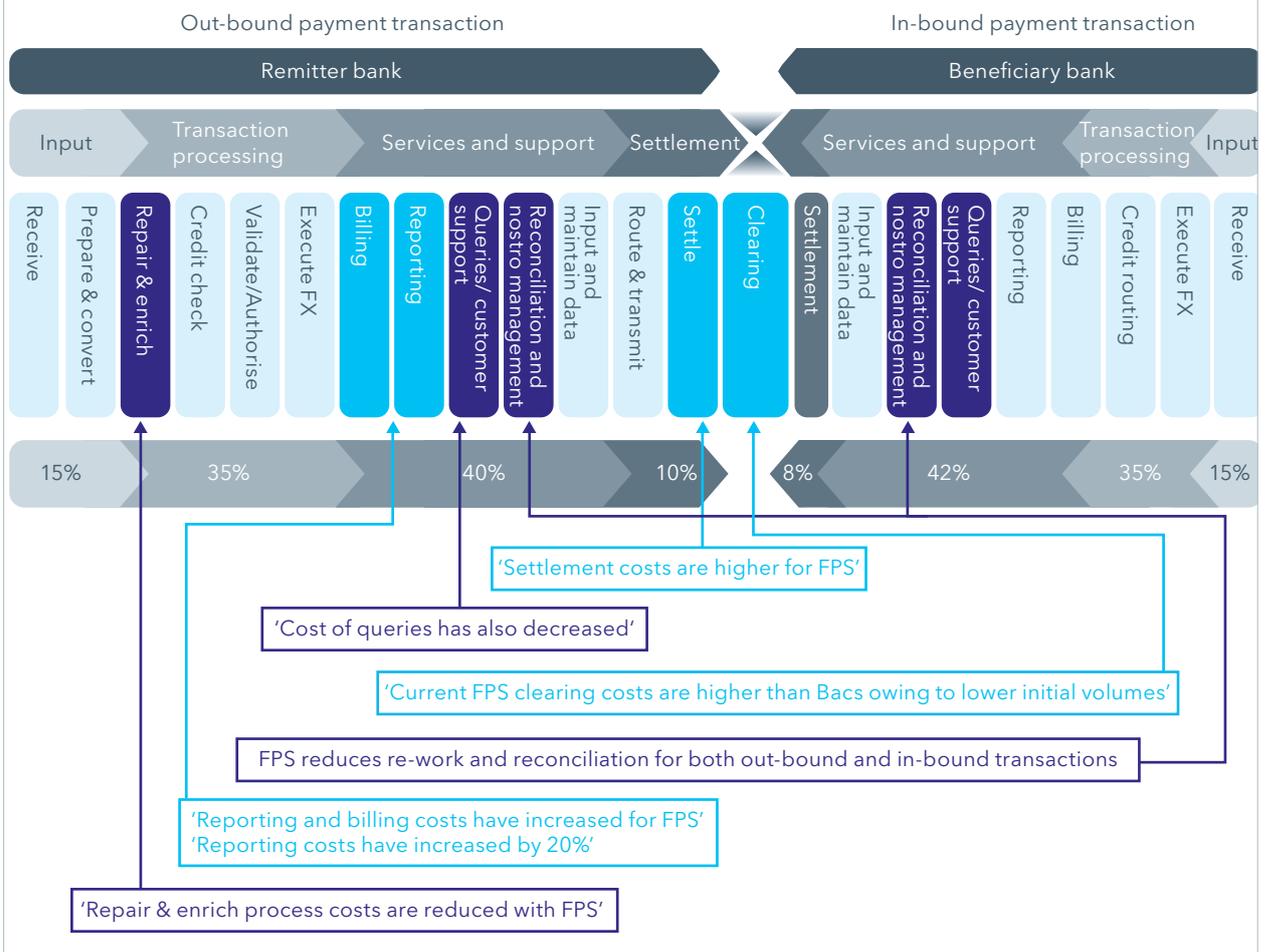
Faster Payments Service, the timing of these changes was brought forward, and thus included in the project budget. However, this may have delivered benefits – one bank commented that as a result, “Faster Payments has led to leaner systems” providing a more solid platform not just for the Faster Payments Service, but for other payment types. Future payment developments may be more straightforward as a result.

### **Leaner operation**

Most banks highlighted the increased automation of the Faster Payments Service above other payment methods as being a net benefit, related to the simplicity of streamlined processing. Several banks identified the Faster Payments Service in terms of the operational costs compared to other payments instruments. These comments assumed that the fixed cost of compliance was part and parcel of the price of being in business, and generally tended to relate to the ongoing operating costs of the service.

Figure 2 shows areas in a typical payment value chain, where the introduction of Faster Payments appears to be having some impact (using a Bacs transaction as a base comparator). Broadly, all but one of those banks surveyed believed that features of the Faster Payments Service will enable payments to be offered at lower cost,

**Figure 2:  
Faster Payments Service running costs comparison to Bacs**



with half those surveyed indicating that for them the service results in less re-work, reconciliation and enrichment with fewer exceptions. This will be more noticeable as volumes increase, although only larger banks may be capable of realising any savings in headcount, whilst other less automated payment services (CHAPS and Bacs) are maintained alongside the Faster Payments Service.

“We’ve had no customer complaints arising from the Faster Payments Service”

A number of banks drew special attention to the remarkably low level of customer complaints in relation to the service, which reduces pressure

on customer facing bank staff. One bank reported no complaints at all, but for the others the complaints tended to fall into the following categories:

- Uncertainty about the proposition and dissatisfaction with the existing level of reach
- Market reliance on being able to pay ‘last minute’ exacerbating channel availability issues
- Their own input errors leading them to pay away to unintended but valid accounts.

Set against this, some banks surveyed indicated that with three settlements per (working) day, the cost of this function is consequently higher (especially for smaller banks) than for Bacs. This cost is driven by the additional oversight and the need to ensure available funds for settlement throughout the day. In addition, the clearing charge is a proportionately higher element, although this (a fixed rather than transaction-driven cost) will reduce as volumes increase.

One bank said that in comparison to Bacs, there is little supporting infrastructure around Faster Payments. One example given was in returns processing. If a payment is made to a valid account – but the wrong one – the scheme does not provide support to request the payment to be returned. Whilst the liability lies strictly with the customer, the bank felt that customers traditionally expect their bank to be able to recover their money in such circumstances, and they were not fully equipped to do so. Whilst another bank recognised this situation, it felt it was regarded as too rare an occurrence to warrant special measures, but may be an area that warrants further investigation as the scheme matures.

### **Managing risk**

All banks agreed that the Faster Payments Service introduced a change to their risk profile. The actual impact on risk depends on the quality and scope of their risk management.

The most important area of concern was in online fraud, where the Faster Payments Service offered the possibility of a ‘fast getaway car’ for those criminals who had already penetrated bank security or subverted related but separate processes. The level of exposure varied between banks, with one experiencing no losses and stating nothing to report in this area, whereas others have had to quickly step up controls to address new threats and loss profiles. A key area resides around online authentication and most banks who had recently implemented strong controls had experienced little fraudulent activity.

There is a general feeling that co-operation on fraud mitigation was a positive benefit for the service, although banks differed in the approach. Some felt the industry has been incorrect in not mandating common security standards and fraud measures initially, whilst some thought that informal data sharing at an industry level would be a suitable level of co-operation. There was general agreement that fraud was best not addressed on a competitive

basis, as this would have negative effects on the scheme as a whole.

### **100% receiver capability is key**

The most important challenge for banks in the short term is achieving universality of the service, that is, reach to all UK accounts. Our analysis indicates that approximately 80% of UK sort codes are now reachable via the Faster Payments Service. This includes most major retail institutions and may represent more than 80% of underlying accounts. Whilst some banks have been able to launch propositions successfully based on the current reach of the service, all surveyed agreed that closing the gap to 100% reach was a priority.

Universality will simplify the customer proposition and create new lines of revenue from corporate customers. It will also enable the retail customer proposition to be simplified, and perhaps, promoted at an industry level. A number of banks see part of their role as being to enable agency banks to connect to the service, which as well as being a source of revenue will also work towards the objective of universality.

### **Why does the scheme set a limit when others don't?**

All banks agreed that the £10,000 limit on Single Immediate Payments (SIP) should eventually be removed – although there was some debate as to what new level it should be raised to or whether a limit should be prescribed by the scheme at all.

Banks reasoned that each bank should be free to control what limit should be applied to its own customers, based on their relationship, credit and credit risk management processes. This would make the concept of limit more of a competitive issue. Some banks also indicated that separate transaction types could be used for specific segments, (for example for house purchase) where particularly high limits might be beneficial and that limits might therefore be better applied in this way for high value payments.

One area that will need to be revisited is the degree to which the future development of the Faster Payments Service depends on co-operative or competitive action.

---

More effective co-operation would help in specific areas such as risk management and standards development

---

To date the focus has been on co-operatively delivering a robust, fully operational system, but now attention needs to turn to fine tuning the scheme. Several suggestions were made by banks in response to questions about where the scheme could play a greater role in co-ordinating activities: fraud, risk management, scheme rules and greater public awareness.

Banks intimated some concerns about how far the development of new customer propositions should be enabled by work in the co-operative space. A key example for all banks consulted was mobile Faster Payments. All those surveyed accept that the mobile will be the technology of the future and cannot be ignored. The degree to which elements of this service will benefit from a co-operative approach including minimum standards and central infrastructure, as opposed to competitive customer propositions, is a key area of consideration.

Looking at developments in the international market and considering the risks inherent in the implementation of the PSD, this consideration needs to be addressed soon and followed by decisive action. Examples of areas for co-operation raised during the study included:

- A proposed 'alias service' enabling beneficiaries to quote a mobile phone number, email address or other such proxy for payment is a key initial step. Banks agreed on the importance of this co-operative measure as an enabler for future development whether

through further co-operation or by building competitively on it.

- Standardisation of reference data use to enable the system to support value adds (such as e-invoicing) and connectivity with third party services.

### **The Faster Payments Service may rewrite the payments market rules**

The benefits of a more complete offering through co-operation need to be set against the perceived agility of a competitive offering. Smart phones, particularly those with mature applications propositions, have redefined the mobile market. There is no reason to believe that the payments market could not experience a similar market changing event, and the Faster Payments Service makes this more likely. The flexibility of the Faster Payments Service makes it more likely the banking industry can play a leading role rather than be circumvented.

---

"We're getting enquiries from all round the world from countries looking to follow our lead"

David McFarlane, CHAPS

---

### **Faster Payments is an international standard bearer**

The financial sector is often criticised for lack of innovation and limitations in competition; however, a more detailed examination suggests that these criticisms are often too easy and sometimes too simplistic.

The UK currently leads the world in developing a network based low-value payment system that has a strong customer proposition and meets a specific customer need to make an urgent payment with certainty and confirmation. Other international developments are different; generally less focused on delivering a clear non-bank proposition or have restricted reach amongst a few participating banks.

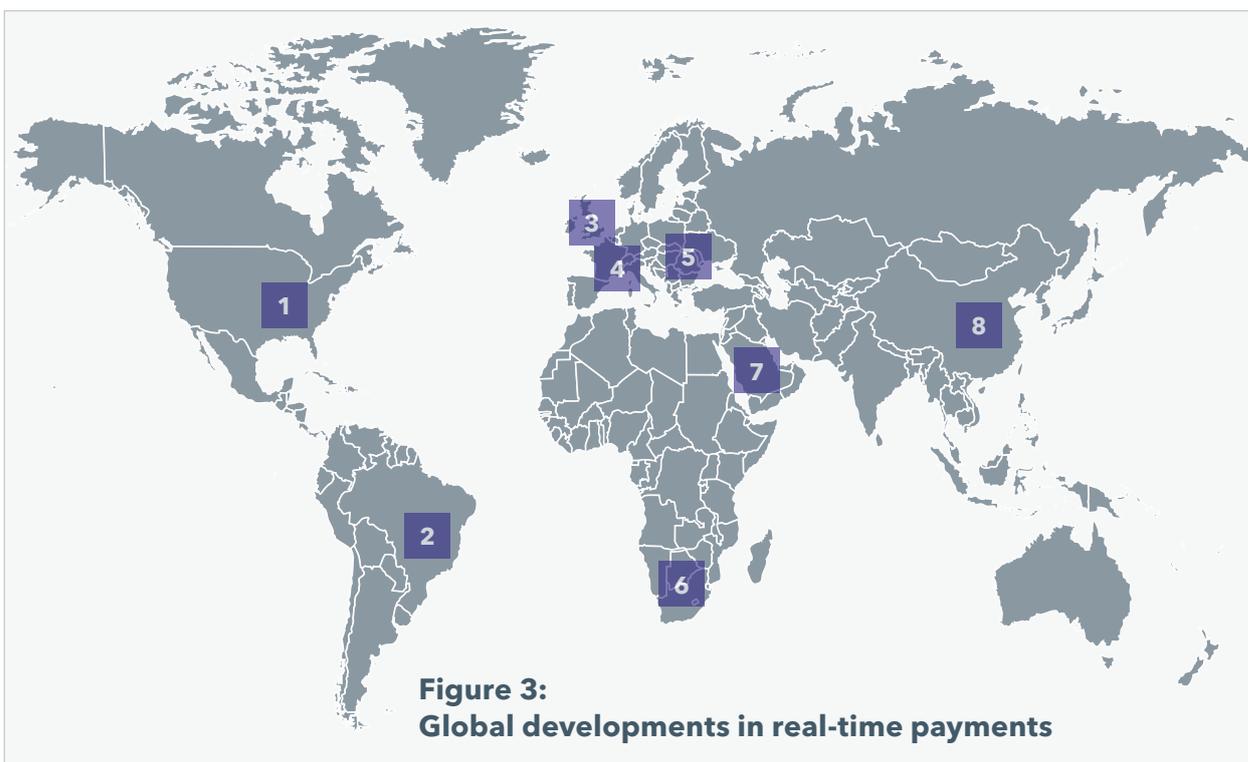
All but one bank thought that the real-time model would be replicated outside the UK, the delivery having 'set the bar' at a new level.

### Faster payments in a global context

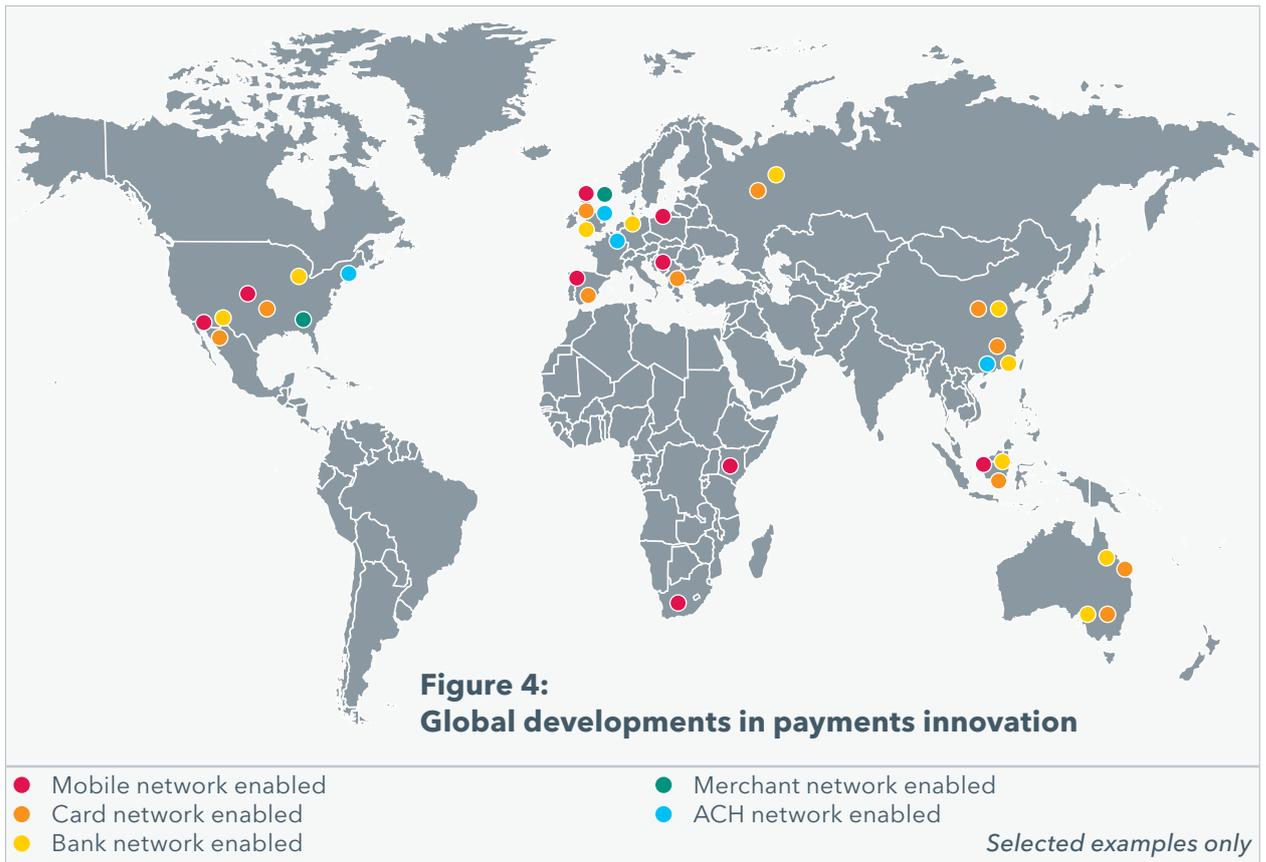
Many developments are taking place across the world which are identified as "real-time". Figure 3 positions some of the most recent developments globally. In the main, these developments rely on the availability of real-time gross settlement (RTGS) platforms, although not all provide a real-time proposition to the customer. RTGS

platforms are the fundamental underpinning of any modern economy and are designed to make high value payments, payments that are systemically significant and payments between banks with finality. They also provide the potential for small volumes of urgent or higher value payments to be made on behalf of corporate or retail customers, as is the case with the CHAPS RTGS service in the UK.

However, these services tend to be limited, as the nature of RTGS leads to restrictions on



- |  |  |
|--|--|
| <p>1 Low value payments system</p> <ul style="list-style-type: none"> <li>- Commercial demand / growth of bilateral exchange</li> <li>- Intraday deferred net settlement</li> <li>- Focus on e-check debits</li> <li>- Planned to go live 2010</li> </ul> <p>2 Urgent payments system</p> <ul style="list-style-type: none"> <li>- Hyperinflation and credit risk key drivers</li> <li>- Real time gross settlement</li> <li>- Commercial payments &gt; R\$5K</li> <li>- No scheme imposed limits</li> <li>- Significant migration from cheques</li> </ul> <p>3 Low value payments system</p> <ul style="list-style-type: none"> <li>- Threat of regulation created investment</li> <li>- Real time net settlement</li> <li>- Scheme limit of £10K</li> <li>- Focus on Internet and telephone banking payments</li> </ul> <p>4 Low value payments system</p> <ul style="list-style-type: none"> <li>- Commercial bank response to UK FPS</li> <li>- Deferred net settlement</li> <li>- No scheme limits</li> </ul> | <ul style="list-style-type: none"> <li>- Focus on euro cross-border payments</li> </ul> <p>5 Low value payments system</p> <ul style="list-style-type: none"> <li>- Absence of legacy allowed investment</li> <li>- Real time gross settlement</li> <li>- No scheme imposed limits</li> <li>- Brought payments into formal sector</li> </ul> <p>6 Low value payments system</p> <ul style="list-style-type: none"> <li>- Commercial bank innovation</li> <li>- Real time gross settlement</li> <li>- Payments cannot exceed R5M</li> <li>- Closed scheme with two participants</li> </ul> <p>7 High value payments system</p> <ul style="list-style-type: none"> <li>- National infrastructure plan</li> <li>- Real time gross settlement</li> <li>- No scheme imposed limits</li> <li>- Provides backbone for national infrastructure</li> </ul> <p>8 Urgent value payments system</p> <ul style="list-style-type: none"> <li>- Trade and commercial drivers</li> <li>- Real time gross settlement</li> <li>- Payments above CNY500K</li> <li>- Supports low value systems</li> </ul> |
|--|--|
- Selected examples only*



access, times of service availability, and volume capacity. RTGS services do not therefore meet the market need for immediate low value, high volume payments. Nevertheless a key function of RTGS is to facilitate final settlement for retail payment systems, of which Faster Payments is one. Most markets have now implemented RTGS, and as a consequence have in place a key pre-requisite for the implementation of Faster Payments.

**The Faster Payments Service is a major payments innovation**

There are many innovations taking place in the payments market place and these are occurring all over the world. Looking at the *Figure 4*, a number of themes can be discerned, specifically:

- Network innovation as well as product-driven innovation is taking place
- Real-time financial infrastructures are enabling innovation to break out of 'pilot' mode'
- Traditional network 'stovepipes' are being removed
- Physical infrastructure limitations/ conditions are spurring innovation

- Significant niche needs are driving innovation, for example mass transit system payments
- Communication companies are actively engaged in propositions and operations
- The underlying technologies are now mature and user friendly
- The card has been an important instrument so far...
- ... but mobile telephones are increasingly important
- Regulation is an important incentive for market development.

The Faster Payments Service is a major innovation in payments and one that is attracting the interest and attention of market makers, regulators and payment service providers globally. The service is also fairly unique in the global market place. It provides the customer with a clear proposition, it provides the customer with certainty and control and it is founded on the real-time expectations of the market place.

### Innovation needn't be rocket science

Several banks perceive the Faster Payments Service as the basic component of many different compelling customer propositions and products.

A Euro variant of the Faster Payments Service was seen by one bank as filling a key gap in the portfolio of UK payment systems, as well as enabling the service to be transported readily to other economies (either as part of the existing scheme or as a parallel scheme).

Other views saw some potential to converge other schemes, such as CHAPS onto the Faster Payments Service platform within the medium term. Although the implications for systemically important payment systems cannot be ignored, and that their very specific needs for immediate finality protected.

One bank commented that a more pressing priority for convergence might be to move all payments to the new international default standard – ISO 20022 XML. This would also have benefits in interoperating and propagating the service globally.

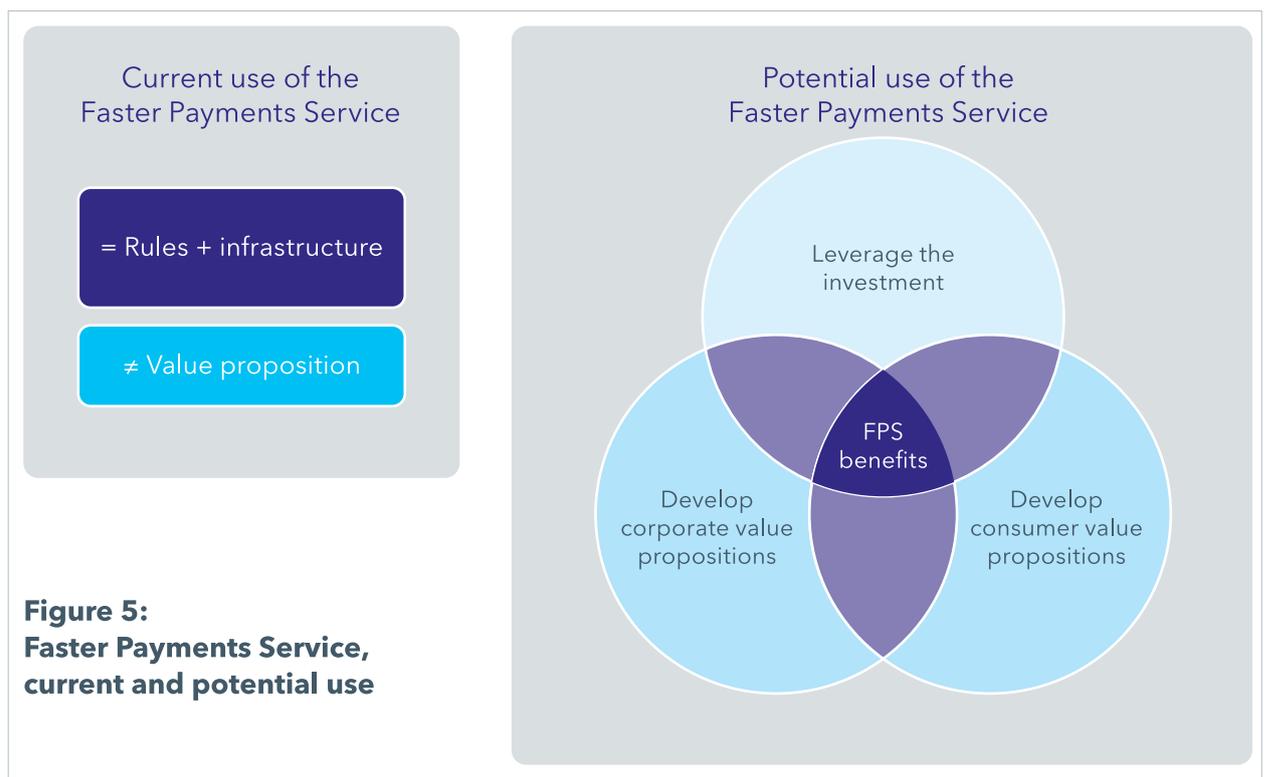
The good news for customers is that people are thinking ahead. The difficult question is whether they will find a voice in the current climate. The commercial environment always plays a very significant role in how initiatives like the Faster Payments Service develop. If you are clear in your view that the Faster Payments Service is part of the cost of being in business in 2009, and that the future is real-time, then the coming years will be easier to navigate.

### From compliance to commercialisation

Most of those consulted feel the bulk of the compliance activity for the Faster Payments Service is behind them. For some this is a matter of pride, for some a relief; the Faster Payments Service is now a reality, and for those playing in the space the focus is now clearly on optimisation, if not commercialisation of the real-time experience.

### I want it and I want it now

The world in 2009 is a real-time world. It is a world where individuals and customers demand control, information and satisfaction with an immediacy never seen before. It is a world of



tweets, blogs and e-mail. It is also a world of consumerism, where customers are not willing to be grateful to service providers, where they are much more demanding of their rights and much more assertive of their expectations.

Care needs to be taken to understand the proposition fully and to position the Faster Payments Service in the crowded customer market place. There is a big difference between a real-time experience and real-time settlement, which is why the concepts need to be distinguished.

From a customer perspective, an immediate payment is one that fulfils a need at the time

needed. In this respect the purchase of physical goods and services with cash or card provide a real-time payment experience. This is also true of the cheque!

This means that the Faster Payments Service has to be more than simply the generic payment instrument it is now. As demonstrated in *Figure 5*, it has to find its niches, and it has to be the better means of payment when competing with other candidate solutions. This always means usability and speed, it always involves risk management and it needs to add value to all parties involved.

## Case study:

# HSBC

---

HSBC was a founder member of the Faster Payments Service. Rather than regarding it as a compliance issue, the bank embraced the real-time technology as a way of introducing new and improved services to their customers and unlocking new revenue opportunities.

### **The challenge**

This project provided a significant challenge for the industry and for some it has acted as a catalyst to modernise business processes and back-office procedures in order to support the real-time model. For others, like HSBC, where this process was already underway, it provided the opportunity to complement their existing technology and investment with an advanced payment mechanism.

The challenge for HSBC was to implement this real-time technology, in an efficient manner, with a strong focus on how the service would be utilised by both the retail and corporate customer base. This foresight enabled HSBC to provide a seamless transition for their customers, whilst delivering a strong foundation, which allows for further development of compelling value propositions.

HSBC's current personal customer offering is to provide free Faster Payments at the point of delivery, which does not provide an area where additional revenues could be easily achieved. However, it has delivered benefits in the form of improved customer loyalty, retention and recruitment. For the corporate market, HSBC quickly realised the opportunities that the Faster Payments Service presents.

---

“We are delighted to have seized the commercial advantages of Faster Payments early. From the outset we regarded this as a technical project with tangible business benefits”.

---

### **The benefits**

The HSBC proposition for the Faster Payments Service embraced the benefits for retail and corporate customers. HSBC envisaged that retail customers would welcome the speed, certainty and convenience of Faster Payments, which can be effected on-line, by telephone or through the branch network. HSBC is one of a few participants in the Faster Payments Service to offer confirmation of when the beneficiary will receive the payment. This feature provides certainty and transparency for retail customers. It was also vital that the new service was introduced with minimal service disruption to customers and strong internal controls were implemented to mitigate risk.

HSBC focussed on areas within the corporate sector where Faster Payments can deliver immediate value, this focuses on two different payment options. Firstly, where businesses have an urgent need to pay their customers quickly and with confidence, they are prepared to pay a premium to send the payments via the Faster Payments Service.

Low-cost, immediate payments also contribute to businesses and individuals managing their

cash better. Retail customers can potentially make payments later, in the knowledge that beneficiaries will receive cleared funds within two hours. New payments have been attracted to the Faster Payments Service, from other non-premium payment channels.

HSBC's obvious commitment to the service helps drive the universality of the service—firstly through their competitive customer proposition, which encourages other financial institutions to follow suit, which in turn makes the HSBC offering more consistent to all. Further, HSBC is already driving revenue through enabling agency banks to access the Faster Payments Service, effectively creating a virtuous circle of investment for HSBC.

Secondly, HSBC has focussed on receivables propositions, which provide value to corporate clients, through focussing on the presentation and reconciliation of data supplied to their customers. Delivering itemised data in near real time or fast batch is the current offering, this provides clear opportunities for customers to integrate their current reconciliation processes to improve cash flow management and provide more flexible services to their own customers.

### **Future roadmap**

HSBC has identified several areas that have the potential to deliver further value to both corporate and retail customers. Some of the key areas for future development include:

- An increase in the cap limits, from £10,000 with the goal of achieving £100,000 within the medium term
- The Faster Payments Service platform has multicurrency capability and while this has not been enabled there are likely to be benefits for customers
- There is a strong potential for the Faster Payments Service to play a pivotal role in cheque replacement. In particular, mobile Faster Payments could provide a suitable offering for person-to-person payments and person-to-business payments. Developments are likely to occur over the next few years.
- The further identification of retail and corporate customers paying behaviour can provide additional benefits in the delivery of customer centric value propositions, with the payment method at the core of each real-time transaction.

### **Operation and risk management**

As with any project of this magnitude there was always the possibility of teething problems. During the first few months of launch, fraudulent attacks were a concern, as online banking controls were probed by fraudsters as is usual with new products/services. However, processes and controls were introduced to mitigate these risks, and these have been refined when needed to deal with changes in fraudulent activity. HSBC has had very few complaints about the Faster Payments Service, and of these, most complaints were raised when a customer found that the Faster Payments Service could not reach a particular destination. As the service achieves near universality, these concerns are reducing fast.

### **The outcome**

Whilst the implementation of the Faster Payments Service has been embraced extremely positively, there is still further work for the industry. HSBC has embraced the service since launch and is adopting a strategic approach which delivers a compelling roadmap to drive customer value propositions. This creates a competitive advantage by improving retail customer service and driving revenue from a receptive corporate and institutional community.

HSBC has capitalised on the opportunity presented by the Faster Payments Service and recognises that payback will be achieved in a reasonable time.



# The payment service user (customer) experience

*This section includes:*

- *A discussion around changing consumer needs in the wake of the financial crisis*
- *Highlights from the consumer research*
- *Some observations on potential Faster Payment use.*

## **Impatience is a virtue**

The mobile, wired and internet society has created an environment where consumers have immediacy and convenience. In payment terms, this consumer is faced with a disconnect, as traditional payments systems have yet to fully meet current needs. However, the cards world has been most responsive to these needs allowing a 24/7 world for some lower value transactions and by regularly exploring ways to enrich and extend the product.

The impact of the financial crisis on customer behaviour has yet to be fully appreciated, although there are signs that some customers are seeking to move away from the traditional banks that have been affected. Several regional banks have reported higher than usual new customer account activity as a result.

## **Payments are a 'core competence'**

Consumer group Which? publishes regular surveys of the financial sector. It surveyed 14,000 people to find out which banks members trusted most with their current accounts, savings, credit cards and mortgages. This revealed that more than half of Which? members said that 'the speed of transaction is a deciding factor in which bank they put their money.'

This insight reveals the value of providing fast payment transfer. As a large majority of consumers hold several accounts, most tend to have one account in which they transfer money in and out of frequently, and the choice of which account is selected would naturally be based on services offered. From the bank perspective, the importance of capturing customer deposits to drive up liquidity and capital has never been more widely valued than it is now.

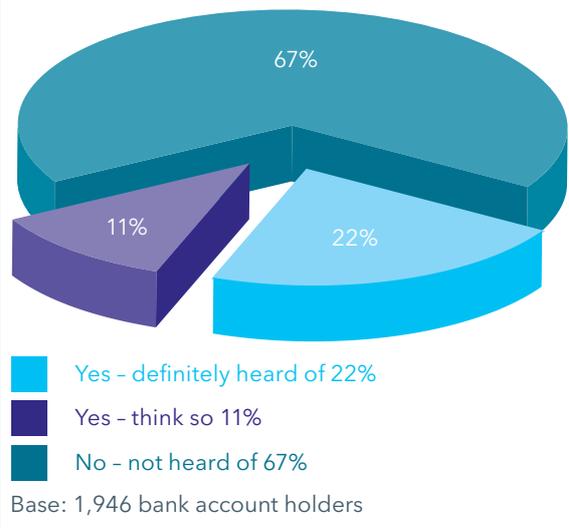
In July 2009, VocaLink commissioned ACCORD<sup>5</sup> to provide primary research in order to assess the consumer experience and awareness of the Faster Payments Service.

Key highlights include (see *Figure 6*):

- A lack of awareness about the service persists amongst consumers: 67% of respondents had not heard of the service. This is consistent with the inability to market the service because of reach issues.
- Those respondents with bank accounts find the idea of real-time payments appealing, with 1 in 4 suggesting that the Faster Payments Service to be very appealing. "I'd never heard of it, but I would pay for it", said one respondent after having the service described.
- 38% of customers who use online or telephone banking channels say they would definitely / very likely use the Faster Payments Service instead of cash or cheque for paying bills such as gas, electricity or credit cards.

<sup>5</sup> Accord survey of 2,011 consumers July/August 2009.

**Figure 6:**  
FPS awareness - Consumer survey results



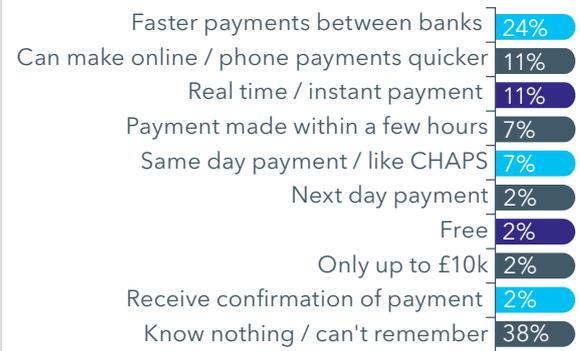
- Greater speed of payments is the key feature respondents are aware of.
- 59% of online / phone bank account holders with a bank which provides the full Faster Payments Service, said they have made payments in the last 12 months.

It is clear from the research that there is still some way to go before consumers are fully aware of the service. To date, there has been very little marketing of the service, although there are signs that this is gradually changing. What consumers currently know about the Faster Payments Service is rather limited, with speed being the key capability that consumers are aware of. *Figure 7 above* reveals the information that consumers know about the Faster Payments Service.

**Ssshhhhh. Keep you voice down or they'll all want one!**

Very few consumers were aware that the service is free, that it has a £10,000 limit, or that

**Figure 7:**  
What do you know about the Faster Payments Service?



Base: 621 all who have heard of Faster Payments  
NB: multiple responses possible

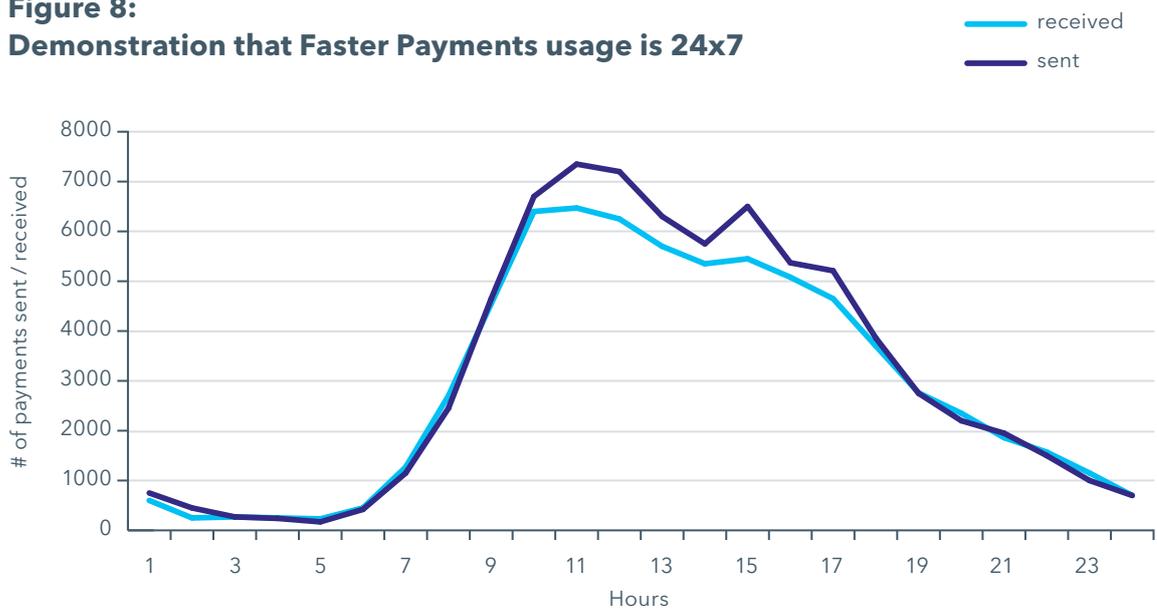
confirmation of payments can be received. It appears that few of the surveyed participants were aware of the 24/7 capability. *Figure 8* shows the average volume of payments made throughout the day. As expected, peak traffic occurs between 9am and 5pm, but the chart also shows signs that the service is beginning to be used outside of these times.

**Consumer insights summary**

Despite low awareness and therefore low volumes, initial results are encouraging. The unique features / capability of the service when compared against other instruments are still yet to be fully articulated to the market, which explains why there is some confusion with regards to what it does and does not do.

Those consumers who bank online are aware of the service and find it more appealing than cheques and cash. However, this is probably already reflected in their online habits.

**Figure 8:**  
**Demonstration that Faster Payments usage is 24x7**



## Customer value proposition – Vehicle purchase

### What is it?

To pay for a car using a Faster Payment with the bank providing confirmation of the payment and optional customer protection services.

While this proposition is particularly suited to the second-hand car market, it could still work well in other vehicle purchase situations. The proposition not only provides an instantaneous payment and confirmation for both parties, but could also provide a car data check as part of the proposition. This check could provide peace of mind for customers in a number of areas including:

- Confirming the ownership of the vehicle and that it has not been stolen
- That the vehicle has not been an insurance write off
- That there is no outstanding finance on the vehicle.

### Why?

This proposition would reduce the risks involved in paying or receiving cheques or cash. At present there are: 1.3m cash and 0.5m cheque transactions used to purchase vehicles. From the bank perspective, the handling of cash and cheques are more expensive than a Faster Payments transaction. The proposition would be priced to reflect the paying moment for the customer that delivers convenience, security and confirmation of the transactions. The added value would be the car data check which is currently charged at between £5 -£10 by current providers. With the advent of mobile 'Faster Payments', the mobile phone can be used to pay for the vehicle and seconds later the buyer would receive a text message confirming the payments plus the car check details. The seller would receive immediate confirmation of payment and would not need to be concerned about transporting the payment.



# Unlocking the value

This section includes:

- The business case for the Faster Payments Service with forecasted volumes and revenues to 2018
- Customer value proposition ideas for potential Faster Payments Service use
- Observations on international application of the Faster Payments Service.

## Business case components for the Faster Payments Service

The following business case is based on insights from the industry stakeholders interviewed, and provides a view on potential volumes and associated Faster Payments Service costs and revenues in the next nine-year market horizon.

---

“We have a 3-year payback period from the investment”

(commented one bank interviewee)

---

## Forecasts of migration volumes to the Faster Payments Service to 2018

The nine-year forecast model is founded on the UK Payment Statistics 2009<sup>6</sup> data for forecast volume growth of payment instruments to 2018 (the nine-year timeframe has been selected on the basis of the forecasted volumes from the Payments Council which also coincides with the

end date for cheques). This has then been flexed to build in a number of key assumptions that follow from the insights and gleaned in this study, including but not limited to:

- The limit increases to £100,000
- Full reach to all addressable sort codes before 2011
- A mobile Faster Payments offering is estimated to take place in 2012
- According to the UK National Payments Plan, cheques will be phased out in 2018
- The recession will continue to impact the payments market in the UK until 2011, and result in changing consumer preferences in the payments space.

Three different adoption scenarios (low, average and high) have been considered, taking account of different predicted use within different customer segments. In particular, migration from CHAPS, cheques, cash, Bacs Direct Credit and non-faster payment standing orders is expected to 2018.

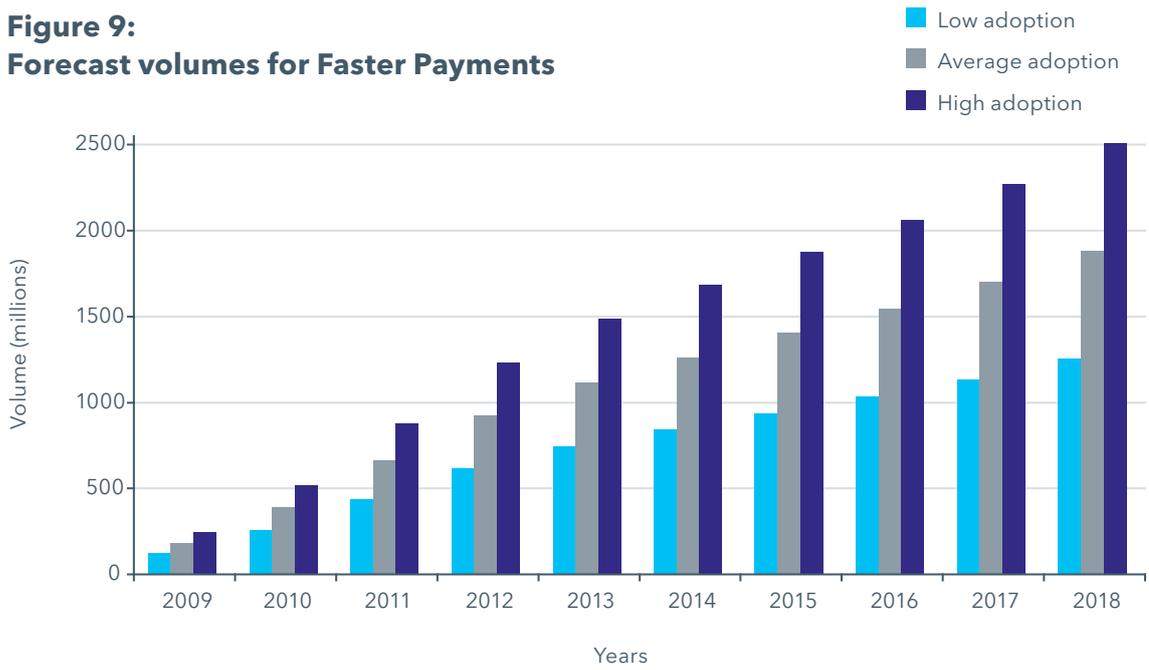
## Faster Payment volumes could exceed 2.5 billion by 2018

Figure 9 overleaf demonstrates the forecasted change in volumes of Faster Payments between 2009 and 2018. Volumes in the high adoption scenario are estimated to reach 2.51 billion in 2018, whereas, assuming a more humble uptake of the service leads to average adoption of 1.88 billion and low adoption scenario accounting for 1.25 billion. The latter is based on modest organic growth from standing orders and some

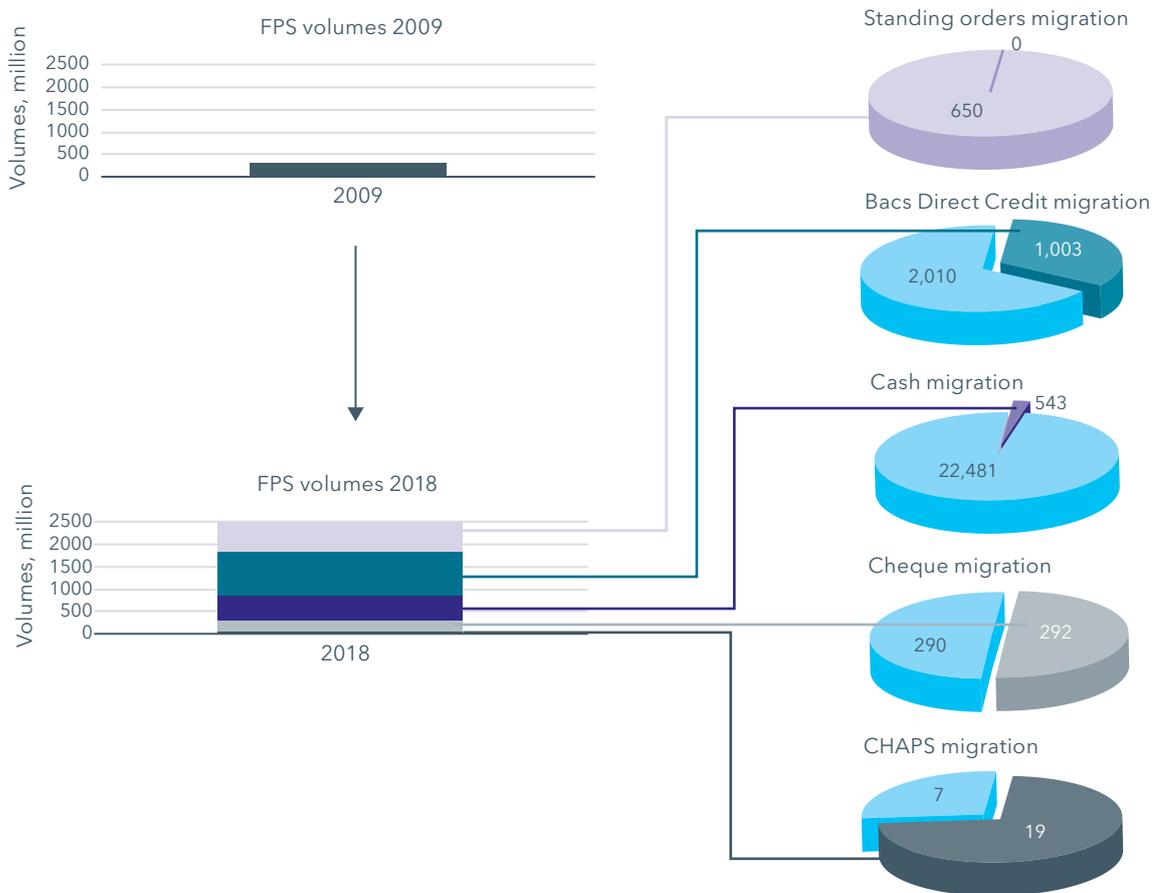
---

<sup>6</sup> UK Payments Statistics 2009, Payments Council, June 2009.

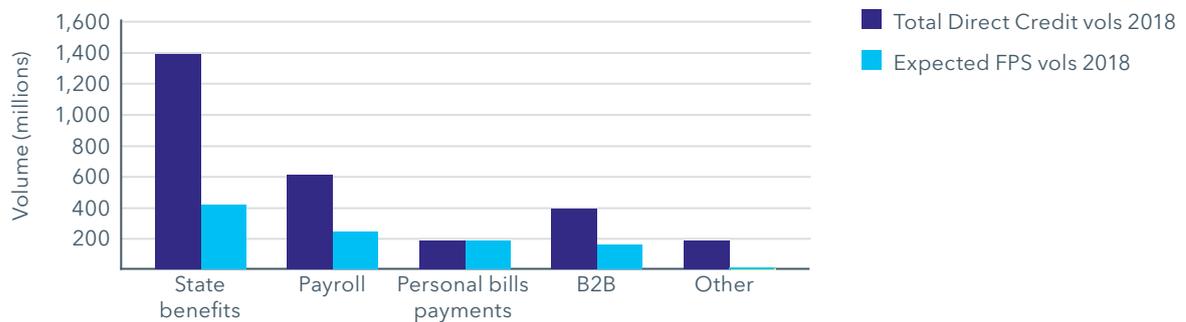
**Figure 9:**  
**Forecast volumes for Faster Payments**



**Figure 10:**  
**Faster Payments migration volumes 2018 - High adoption case**



**Figure 11:**  
**Total Direct Credit volumes in 2018 (Bacs and expected FPS migration)**



CHAPS and Bacs Direct Credit volumes with limited adoption of mobile Faster Payments in the UK. The higher adoption forecast assumes strong competition amongst participants early on from real customer value propositions including mobile Faster Payments. It also assumes no limits, 100% universality and strong corporate uptake.

The total volumes indicated in *Figure 9* have been derived from migration volumes from other payment instruments to Faster Payments. These are presented in *Figure 10* for the high adoption scenario.

### **Faster Payments - a growing force to be reckoned with**

The largest migration of nearly 1 billion (approximately 33%) is expected from Bacs Direct Credits. A further breakdown of modelled migration is shown in *Figure 11*. Bacs Direct Credits are predominantly used for payments made by Government and businesses, and some migration of volumes (around 40%) is expected in these segments due to the immediate and certain nature of Faster Payments.

The Faster Payments Service can also address several other issues:

- Useful for payments of state benefits in case of emergency and rising unemployment benefits
- Can provide a contingency for payroll issues where Bacs Direct Credit has failed
- Can overcome known payroll issues regarding weekly contract workers. In this latter case, workers typically paid on a Friday currently

require employers to choose between making a Bacs instruction before the final day's work is done or using a costly CHAPS payment. Both are open to problems either in terms of expense or unfulfilled work commitments

- Can provide scope for payday lending outside of normal working hours and weekends.

Further leverage of Faster Payments could include settlement of dividends, immediate refunds in respect of customer complaints and insurance claims. There should not be any limit on innovation either!

### **Steady organic growth or a 'one trick pony'?**

As an inherent part of organic growth, increasing amounts of standing orders are being processed through the Faster Payments Service, and it is expected that all standing orders will go through the Faster Payments Service in the next few years. This will account for 650 million transactions in 2018.

### **Reaping benefits from corporate customers**

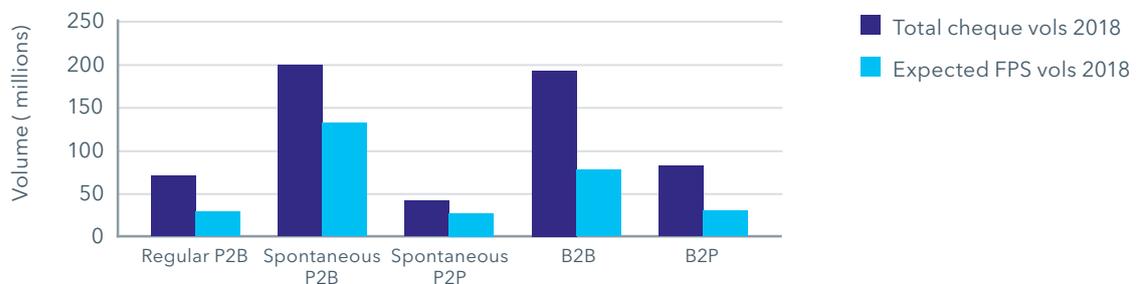
A major potential benefit for customers lies in the low-cost aspect of the Faster Payments Service and is therefore seen as displacing CHAPS volumes (50% of which are below the current limit of £10,000). This will not apply to systemically important and high-value payments requiring RTGS capability. Over 60% of CHAPS migration volumes predicted in 2018 (*Figure 12 overleaf*) are derived from:

- Corporates, financial and other higher value payments (some of urgent nature)
- Smaller businesses which have a need to

**Figure 12:**  
**Total CHAPS volumes in 2018 (CHAPS RTGS and expected FPS migration)**



**Figure 13:**  
**Total cheque volumes in 2018 (cheques and expected FPS migration)**



manage more effectively their cash flows in order to survive in challenging economic conditions

- Supplier and trade payments currently depressed as a result of recession but expected to rebound in due course.

These business-driven volumes will be significantly boosted with the increase in limit which will allow higher value transactions to be processed. This will open up a wider market for housing-related CHAPS volumes (around 10% of total migration) to go through the Faster Payments Service, and empower the personal customers to take advantage of speed and low-cost opportunity offered by this service.

According to the UK Payment Markets 2009<sup>7</sup> report, there will be a small migration of volumes of CHAPS payments that come from abroad. Implementation of this requires scheme members to upgrade their anti-money

laundering systems to account for receipt of the cross-border transactions, and for this reason it is not forecasted to take up much of current CHAPS transactions. Overall, it has been predicted that over 70% of CHAPS volumes will migrate to the Faster Payments Service in 2018.

---

The Faster Payments Service will battle with plastic to gain the cheque market share

---

Another major increase in volumes is expected to come from declining cheque usage, as the industry seeks to eliminate these by 2018 in an effort to move away from high-cost payment instruments. *Figure 13* demonstrates the cheque displacement trend in the predominantly personal customer space.

<sup>7</sup> UK Payment Markets 2009, Payments Council, June 2009.

Personal cheque use is predicted to rapidly lose its market share until 2018 in the retail, travel and entertainment sector, primarily to plastic cards and cash. Over 20% of cheque migration volumes are forecasted in spontaneous person-to-business segment, with applications ranging from school trips to trade payments.

There is significant potential for a substantial amount of personal customer payments to be propelled via mobile Faster Payments, which is included in the model due to important value proposition stemming from this payment channel. In addition, the number of remote banking users is predicted to grow creating further potential of cheque displacement in the retail market.

Cheque migration to the Faster Payments Service in the business-to-business and business-to-person transaction space has been modelled at a lower rate due to slower decline in the use in these segments, although the combined migration volumes are expected to reach 100 million by 2018. Summarising, half of the cheque volumes are assumed to migrate to

Faster Payments in the next nine-year period, whereas the other half is expected to boost the cards business.

### **The Faster Payments Service takes on cash**

Despite repeatedly reported high cost of cash, the use of this entrenched instrument will continue to rise accounting for approximately 45% of all payment transactions in 2018, as reported in the UK Payment Statistics 2009 forecast. Card use (especially contactless technology and prepaid cards) is also predicted to grow steadily displacing some of the cash volumes. Cash migration to the Faster Payments Service for spontaneous personal customer use could be considerably enhanced with mobile Faster Payments forecast to take off in 2012 or earlier, although the overall number is predicted in the region of 540 million.

The migration from cards to Faster Payments has not been modelled in this work due to a belief that there would be no notable migration from this well-established revenue-generation mechanism. What has also been excluded from the analysis is the impact of new transaction

## Customer value proposition – University and School Payments

University and school payments are an example of how customers are restricted in their payment options. University and school institutions tend to request parents and students to pay by either cheque or cash (For example there are a number of payments made by parents for school trips and transport). The Faster Payments Service enables customers to pay educational organisations immediately and through the online channel and it can be extended to other instances where organisations have thus far insisted on specific payment options.

### **Customer need and benefit**

- Organisations that receive high value payments have tended to opt for payment methods that have traditionally been seen as secure and reliable, such as cheque payments and cash. Educational organisations are prime examples whereby they do not accept card payments or bank transfers. Faster Payments has the potential to provide more assurances to organisations as high value payments are made and confirmed instantaneously with the benefit of providing the necessary reference data.
- On the flip side, parents and students who make these payments will now have an additional and arguably more convenient payment option, which would be suitable for the online channel.

## Customer value proposition – Release of Goods Payment service

This proposition enables customers to exchange goods in an environment of trust and could potentially provide an enhancement to current international trade arrangements. The recipient of goods releases payment immediately upon receipt of goods.

### Customer need and benefit

Both customers and merchants, or in the case of person-to-person transactions, both payer and payee want guarantee and as much certainty as possible in the outcome of an exchange or transaction. For example, merchants want to be sure that they will be paid for goods despatched and customers want to be sure they receive the goods that they have paid for. Faster Payments could potentially provide a solution to this dual customer need; since it is based on immediate transfer of funds, prompted by a specified event.

### Customer experience

The proposition example below looks at how secure identification and physical security can also be utilised to offer a “release of goods” proposition.

- Business A goes online and visits Business B’s web site and selects goods
- Business A completes payment details and selects Faster Payments “Release of Goods” option
- Business B delivers the goods at Business A premises
- Business A logs back on to their online banking channel and selects option that makes the payment (all details have already been entered) and confirmation is sent to Business B

The proposition has potential to be more sophisticated whereby goods are delivered off site and automated processes trigger immediate payments and confirmation once the goods are delivered and received at the requested place.

### Revenue potential / model

There is scope for the banks to charge both the recipient and sender of goods as well as explore value added services such as off site delivery points. The proposition is applicable to both person-to-person transactions and business-to-business transactions.

instruments or the inevitable growth of the contactless and prepaid cards domains. It is acknowledged that these instruments would add their mark on the payments market make-up, especially in the retail sector. The second part of this study will aim to gather more insights around consumer perceptions of the merits of these payment instruments.

It is important to note that the question of commercialisation of the Faster Payments Service is a function of speed of uptake as well as the total volume migration in the next nine-year period. Factors that are expected to influence this include success in the uptake of the mobile payments channel, timing of limit

increases and full reach to all sort codes, and credibility of provision of extra value-added services. Last but not least, the support from the Government is likely to become a further catalyst of change towards greater use of the service.

### A note on costs – a future projection

The current average unit cost of a Faster Payment transaction would be very high if capital costs were included in the calculation. Although this will fall significantly over time as volumes increase, it is safe to assume that this will approach the level of a well-established payment instrument in the next nine-year period. High straight-through processing (STP) rates will also tend to keep variable costs low. The real

prize is the elimination of the fixed costs of another scheme – particularly the cheque. It is hard to imagine removing the cheque without a viable alternative and mobile Faster Payments could be the ‘extinction level event’.

On a cautious side, there will be further implementation costs associated with introduction of mobile Faster Payments, as well as further refresh technology costs. The level of required investments needed to effectively manage the change depend on the level of operational efficiency within banks and are expected to vary by as large an amount as with the original implementation costs for the Faster Payments Service. This would further create competitive advantage for some of the better equipped banks leading to a consumer choice and a revenue potential for banks.

### **Imminent opportunities to charge**

Although the research from the OFT report 2005<sup>8</sup> identified a potential to charge for value added services, the UK banks decided not to take this opportunity to charge their retail customers for the Faster Payments Service. The rationale is clear, but it does not mean that the decision was right. The charging process for cheap airline tickets, for ring tones and for internet payments all demonstrate the consumers’ propensity to pay for value. The question now is whether the value added services of this innovative scheme could potentially create an environment for new revenue growth opportunities?

Based on the forecast volumes, *Figure 14 overleaf* summarises the range of revenue opportunities within the corporate and retail space. The fees for the Faster Payments Service will be determined by market forces, but an indication of the range of potential charges is provided for indication.

<sup>8</sup> An economic analysis of the potential and dis-benefits of Faster Payments clearing”, Office of Fair Trading, Alistair Milne and LeiLei Tang, May 2005.

The size of the prize is significant in a business-to-personal space with forecasted revenues between £1.9 billion and £2.9 billion in 2018, as well as in business-to-business domain (ranging between £1.2 billion to £1.9 billion). These figures have been based on a few assumptions distinguishing primarily between payment value bands which will become more relevant once the limits are increased, as well as availability of extra value-added options (for example, mobile Faster Payments). It has been assumed that for the top 20% of transactions in terms of value, the fees could range between £5 and £7, the bulk 50% of volumes could provide an opportunity to charge £3 to £5, whereas the rest of transactions could involve a fee around £1.50. Clearly, each individual payment services provider will have a choice to offer charging packages depending on the level of customer value proposition, market demand and competitive landscape.

---

“A great deal will happen over the next twelve months” (with reference to developments of the Faster Payments Service)

Paul Smee, Chief Executive of the UK Payments Council

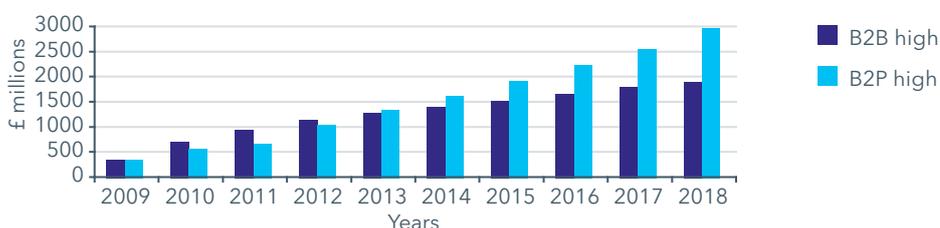
---

In the personal customer segment, there has been no revenue generation since the introduction of the Faster Payments Service in 2008. However, there might be opportunities with the estimated adoption of mobile Faster Payments in 2012 which would enhance the customer experience of speed, convenience and simplicity.

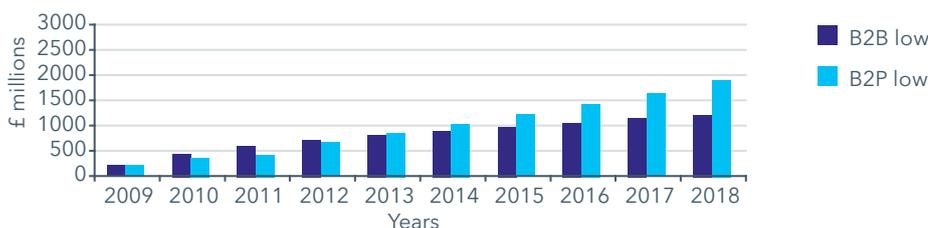
Mobile banking is rapidly developing as an emerging banking channel and a 21st century alternative to traditional branch and telephone banking. Its potential is widely acknowledged to offer new products and services to existing and new customers, allowing financial institutions to

**Figure 14:**  
**Forecast revenues for Faster Payments**

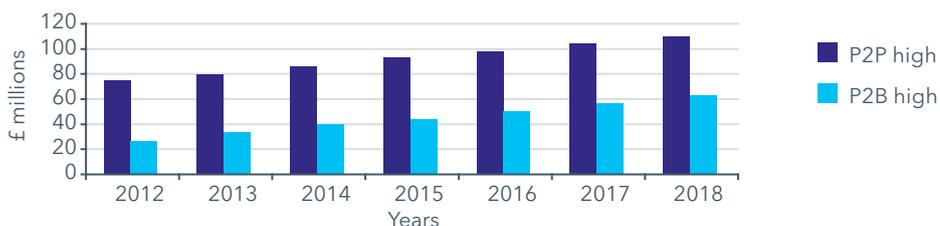
(a) Forecast revenues B2B and B2P



(b) Forecast revenues B2B low and B2P low



(c) Forecast revenues P2P and P2B high



(d) Forecast revenues P2P and P2B low



generate fresh revenue streams. The main consumer benefits would stem from an ability to avoid carrying cash for low value payments and flexibility of making payments everywhere within 24/7 timeframe, but also from extra value-added services, for example an option to trace payments instantly via notification of transaction or an email alert, improving security via authentication mechanisms etc. Based on assumed fees of £0.20 – £0.25 per transaction, potential person-to-person revenues predominantly from the mobile Faster Payments are in the range of £87 million to £109 million in 2018 with some further opportunities in the

person-to-business space adding to £50 million to £62 million.

The revenue model has not included the potential impact on revenues from developments in new payment instruments, such as contactless cards. Online payments using the Faster Payments Service platform have not been mentioned in the revenues discussion as there are a number of challenges to overcome. Nevertheless, the advantages of online Faster Payments are described below.

## Customer value proposition – Online payments

---

“Online shopping payments using the Faster Payments Platform will happen, but there is an uncertainty of when. It is likely to occur competitively”

Paul Smee, Chief Executive of the UK Payments Council

---

### What is it?

Online shopping continues to grow steadily despite current economic conditions with a year on year increase by 14% (June 2009, IMRG). The current prominent payment types for online transactions are debit cards, credit cards and specialist e-payment providers. Faster Payments enables banks to offer an online payment method to customers which do not require customer card details. Online Payments allows customers to pay for goods online directly through their online banking channel.

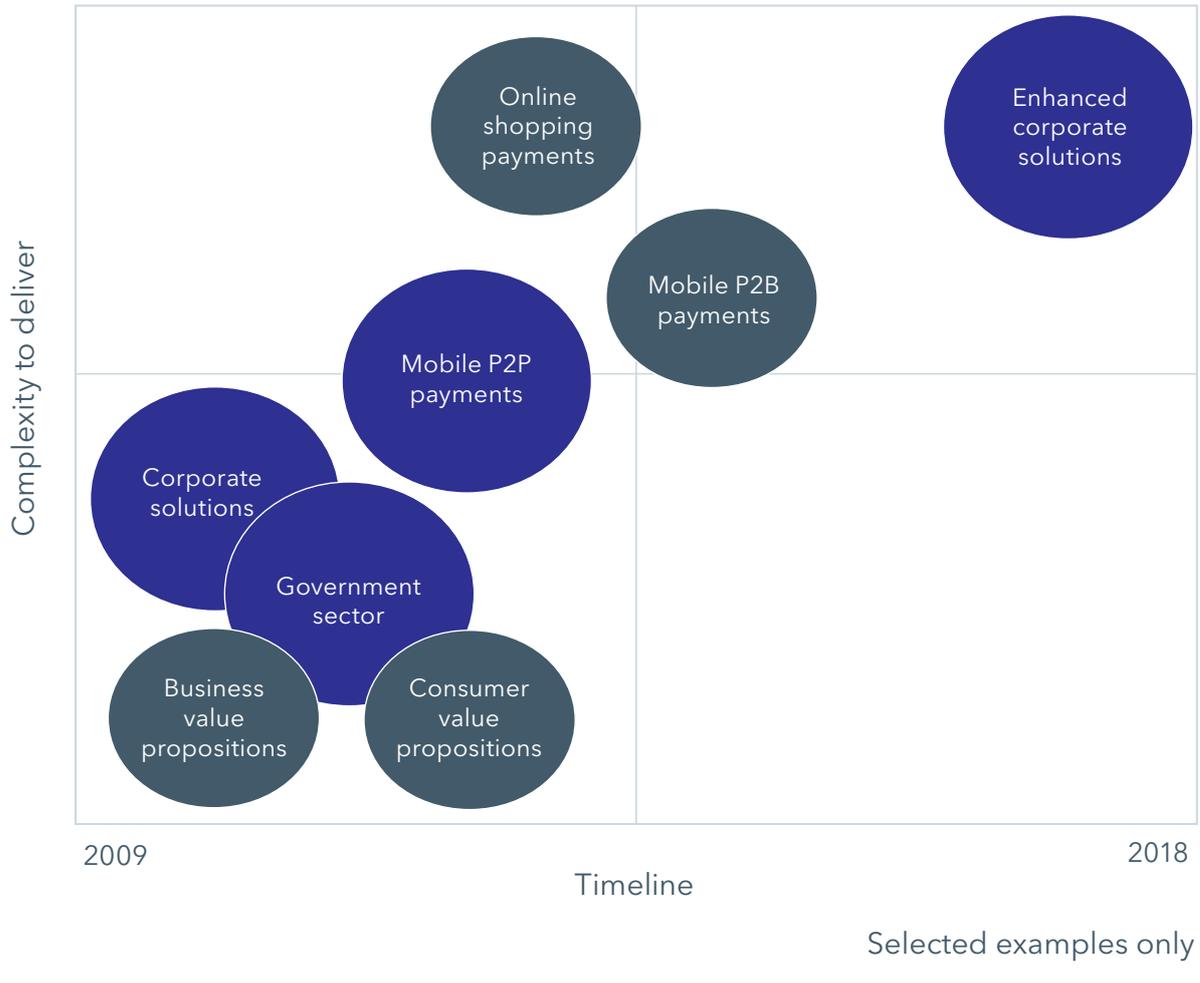
### Customer need and benefit

- A Vocalink research study carried out on online payment behaviour indicated that security and fear of fraud were the primary drivers of selection at the point of sale with 75% and 10% rating these factors as most important. Similarly, some customers are reluctant to disclose their debit or credit card details online. Online Payments removes the need to enter card details online and more importantly, money is transferred directly and immediately from the customer's bank account online.
- Merchants continue to look to manage operational costs and online merchant fees represent such costs. Credit cards are a convenient form of an online payment tool but merchants do have to pay a relatively high percentage for credit card transactions. Online Payments potentially presents an efficient payment mechanism for both customers and merchants.

### Customer experience

- Customer chooses good from online merchant site and selects Online Payments as payment option
- The customer is asked to confirm their bank and they are then routed to their online banking channel
- Once logged on, as they normally would, the customer can see details of the online purchase on their online bank channel. They are asked to confirm these details and the payment goes through in real-time
- The customer is re-routed back to the merchant's website and a confirmation appears to inform the customer that the payment has been made.

**Figure 15:  
Faster Payments Service proposition matrix.**



**Fortune favours the brave and the brave have a choice**

Figure 15 shows the myriad of customer value propositions depicted over the next 9 years rated by complexity to deliver. These ideas have been gleaned from the interviews with the payment service providers and key industry stakeholders. The different sized circles highlight the revenue opportunity of some of the customer payment propositions which have been discussed throughout this report (for example P2P mobile Faster Payments, insurance, vehicle purchase). While we have mentioned some of these propositions, there are many more opportunities for the brave to choose from in order to create a compelling customer value proposition. These include but are not limited to:

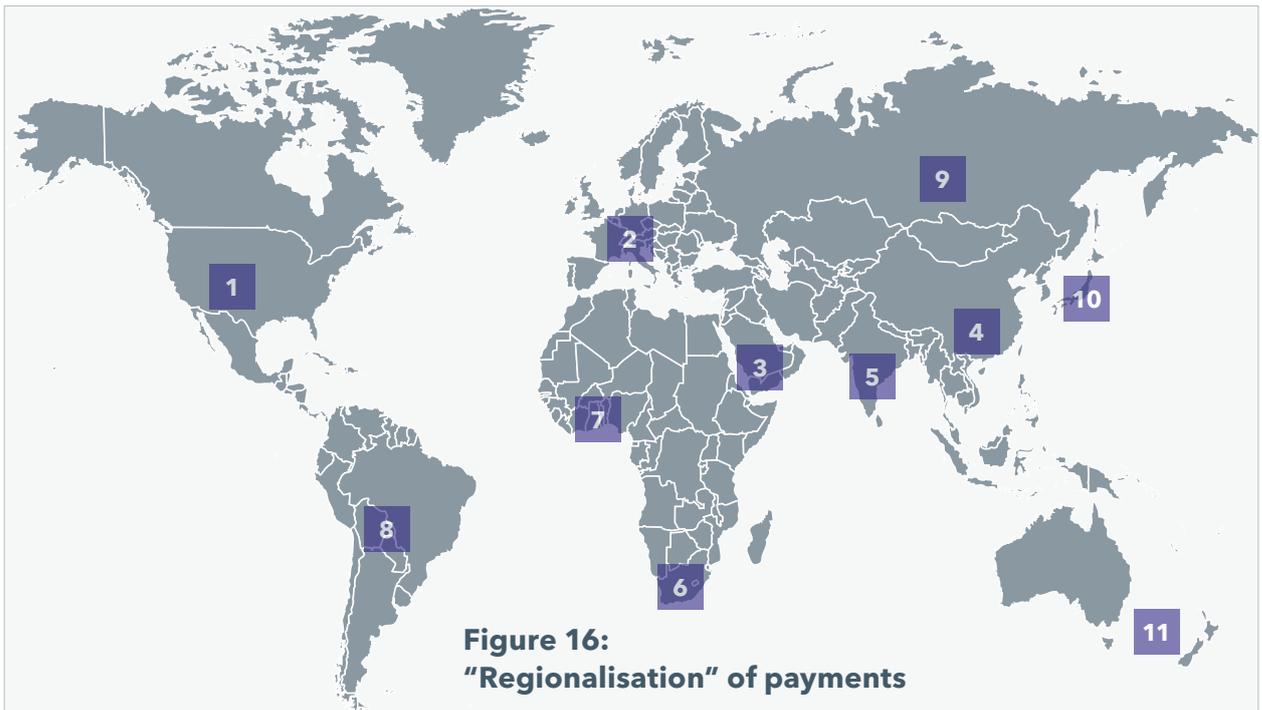
- Numerous opportunities with the corporate sector (some of these are mentioned in the

- HSBC case study)
- Government sector payments (e.g. State benefits, tax payments)
- House purchase
- Last minute payment of credit card bill
- Payments to and from small businesses
- Sending money abroad in an emergency
- Intrabank admin transactions (payments between different parts of the organisation)
- Stocks and shares payments.

We will be seeking to elaborate on all of these propositions during the next phase of this research which will incorporate perspectives from the retail and corporate customer base.

**International leverage for Faster Payments**

There are several established trends affecting the development of payments internationally,



**Figure 16:**  
**“Regionalisation” of payments**

- |  |                            |
|--|----------------------------|
| 1 North America                          | 7 Western Africa           |
| 2 Europe/Single Euro Payments Area       | 8 Latin America (MERCOSUR) |
| 3 Gulf Cooperation Council Member States | 9 Russia                   |
| 4 China                                  | 10 Japan                   |
| 5 India                                  | 11 Australia/New Zealand   |
| 6 Southern Africa                        |                            |

and these are impacted by global innovations such as the creation of a mass market and low value Faster Payments Service for consumers in the UK. To understand where and how the Faster Payments Service will affect international developments, two issues need to be understood:

- Regional integration (see Figure 16)
- Market infrastructure modernisation strategies.

**Regional integration - Europe, America, the Gulf and Asia**

Europe already has an advanced level of regional integration. The euro, and the creation of SEPA all reflect the relentless improvement in the regional efficiency of the payments market within and between the developed economies of Western Europe.

This compares favourably with the North American dollar payment infrastructures. Although there are many similarities between the evolution of the US payment market place and that of Europe, the changes that have more recently taken place

in Europe are now redefining established requirements in the US too.

Europe and America are not alone in their intent, thinking and action. The member states of the Gulf Cooperation Council are working to modernise and integrate the payments infrastructure within that region. Challenged by the need to diversify their carbon based economies, enjoying the opportunity of substantial capital reserves and recognising time zone advantages, the potential to link the European and Asian payment markets is obvious.

Asia is less well integrated at the market level, but its dynamism, history of innovation and current GDP growth rates all mark it out as a vital component for all future scenarios. Additionally, the size of the market place in China in its own right compares favourably with their regional counterparts in the Northern Hemisphere.

Development in China is stimulated by international trade, foreign direct investment as well as by the local business environments of Hong Kong and Macau. Commercial solutions have also emerged between Hong Kong and Malaysia, which serves as a model for future developments.

India is also a major market place in its own right and in many respects reflects the situation that confronted China when the latter embarked on its national payments infrastructure strategy. With substantial commercial trade flows, a demand for foreign direct investment and a need to formalise the markets, India is beginning to tread the path already trodden by others.

There are, of course, regionalisation agendas in other parts of the world including developments in Latin America, Southern Africa and Western Africa.

Regionalisation has a number of implications for the payments market place. Regionalisation means co-operation and this means standardisation. It also creates the opportunity for rationalisation within the market infrastructures. This can drive up economies of scale in surviving businesses and reduces the average unit cost of payments.

Currently, regional integration is largely achieved through correspondent banking models, but these are being eroded through the process of regionalisation, market solutions and the development of new international standards such as the international ACH transfer.

Each region therefore needs to establish the market infrastructure that best meets its current and future needs. This means that it has to address either the market, or regional, developments that will most shape the demands of its customer base and international competitiveness.

A position on a mass market low value Faster Payments proposition seems to be an essential part of this debate.

### **Modernising market infrastructures**

When discussing market infrastructure strategies there are often two recurrent aspects to the discussion:

- A legacy exists, which challenges possible options and the pace of change
- A recognition that with free choice a strategic design 'wouldn't start from here'!

Legacy in emerging economies can often mean high cash usage, paper-based instruments, substantial informal sectors and large remittance flows. It does not always mean a large installed IT legacy, which therefore allows the opportunity to migrate to 'best of breed' solutions at the outset. This is as true in parts of Asia as it has been in the recent accession countries to the European Union.

Where local banks support local economies, the level of sophistication of payment solutions can vary significantly. Typically, these solutions have evolved over time and have not therefore been part of a coherent market level strategy. This is particularly relevant when moving from a significant agrarian economic base.

As emerging economies modernise, a number of trends are apparent, including:

- The focus on market competitiveness (efficiency, cost effectiveness and rationalisation)
- The adoption of developed economy best practices and standards
- The deployment of high speed telecommunications network for message processing
- The development of RTGS systems, offering real-time interbank and commercial solutions
- The use of bulk entry payment systems based on automated clearing house models
- The dematerialisation of cheques with electronic data interchange
- The drive to reduce the informal sector and

therefore to promote non-cash payment alternatives

- The promotion of card-based solutions
- The deployment of mobile telephony and online based solutions.

Given the sustained growth of new economies, there are multiple market opportunities for further developments in payment instruments.

The Faster Payments Service in the UK sets a new standard for:

- Best practices and market competitiveness
- Meeting new consumer and corporate demands
- Real-time payment solutions
- Creating customer value propositions in the online and mobile telephony segments
- Stimulating migration from expensive use of cheques.



# Conclusions

## **The Faster Payments Service is at a critical point of its development**

The hard work by participating UK banks to align back-office processes and exchange payments to exacting service levels has been largely accomplished. However, the number of direct participants remains relatively low.

On the way, many challenges have been encountered and overcome - for example in managing the risk profile of a service with a window on the world that is open twenty-four hours a day, seven days a week. However, some challenges, for example in industry policies around the recovery of irrevocable payments, will require further attention. But, putting aside challenges, the payments world has changed.

## **The service now needs to mature and earn its keep**

The Faster Payments Service has supported many millions of payments between customers - and customer expectation has been raised to the extent where there is no going back to previous service levels. The service has set a new standard and banks are confident that where there are restrictions to growth - in reach or in the value limit on each transaction - these will be overcome through competitive pressure and commercial need.

Operationally, banks have had to implement the Faster Payments Service alongside other instruments, incurring new, fixed costs. However, significantly, some banks are already able to

point to areas where the cost of operation is leading to a reduction in operational costs, most notably in the areas of exception management.

The Faster Payments Service is rapidly moving from infancy to maturity, and as it approaches its adulthood, it must earn its living. Initially, the corporate marketplace has enabled some banks to develop robust sources of revenue from customers, which see the ability to make or receive payments instantly as a key component of their own product offerings.

As time goes by, we predict that businesses will recognise the greater flexibility of Faster Payments to integrate within existing business processes. Amongst those banks interviewed, those who are already helping businesses in this way are already showing revenues that exceed costs, and predicting an early payback on their original investment.

## **The low profile launch has inhibited demand and market awareness**

Our research shows that the Faster Payments Service as a proposition and also as a brand is not well recognised in the retail market. This is primarily due to its low-profile launch.

However, our research and analysis also shows that the Faster Payments Service delivers important customer requirements that people have of their payments instruments - instant delivery, convenience and simplicity. Like air and water, people want their payments to be 'just there'.

### **The Faster Payments Service has been offered as a 'free good'**

Competitive pressure, as well as the lack of a clear product proposition, has led to the Faster Payments Service being offered free of charge. This has set expectations for future consumer payments using the basic service.

### **Further development will be competitive, but collaboration will also be needed**

The Faster Payments Service sets a standard that brings banks back into alignment with customer needs and expectations. It should therefore provide a platform on which to develop value-added services. For this to be the case, there is a need to have more compelling customer propositions.

It is likely that such propositions will be developed on a competitive basis, only involving further collaboration where it will deliver undeniable benefit to the proposition. One area where collaboration is both likely and vital lies in the development of mobile-phone based propositions.

### **The Faster Payments Service will grow over the next nine years**

Banks we have interviewed during this study have all shown themselves to be closely engaged with the Faster Payments Service and see it developing significantly within the UK.

Our research indicates that in the most optimistic scenario, but still one which uses a

relatively conservative set of assumptions, the Faster Payments Service will:

- Become the dominant credit transfer instrument in the UK, and one that refreshes banks' ability to deliver payment revenue across all sectors
- Take volumes from existing Bacs Direct Credit services as well as from CHAPS
- Help to eliminate cheques
- Has the potential to reduce the growth in cash.

Overall, potential revenues have been forecasted, in the business-to-consumer segment, to reach £2.9 billion by 2018 and those in the business-to-business space - £1.9 billion.

Beyond the UK, the banks we consulted envisage the model being replicated. Real-time is the new benchmark for mass payments developments and the essential platform to reliably support the ever increasing mobilisation of banking and payment services.

### **The next steps**

The next phase of this study will focus on the corporate and retail consumer marketplace in order to explore their needs and requirements in a greater detail. We will also seek to identify and examine the full benefits in these markets.

We will also be seeking to update this study in the coming years as the story unfolds and the service matures. We welcome feedback from the industry and encourage opinions on areas that would benefit our collective thinking further.

# Appendices

## **Appendix 1: Contact Details**

We hope you find this study interesting and informative. Please contact us if you would like to discuss any aspects of the report.

### **VocaLink**

www.vocalink.com  
Nick Senechal  
Drake House  
Homestead Road  
Rickmansworth  
WD3 1FX  
United Kingdom  
T: +44 (0)870 920 8613  
M: +44 (0)7966 073093  
e: nick.senechal@vocalink.com

Pat Patel  
Drake House  
Homestead Road  
Rickmansworth  
WD3 1FX  
United Kingdom  
T: +44 (0)870 920 8571  
M: +44 (0)7989 695507  
e: pat.patel@vocalink.com

### **PricewaterhouseCoopers LLP UK**

www.pwc.co.uk  
Mark Hale  
Hays Galleria  
1 Hays Lane  
London  
SE1 2RD  
United Kingdom  
T: +44 (0)207 804 2958  
M: +44 (0)7713 653379  
e: mark.j.hale@uk.pwc.com

Marija Nikolic  
Hays Galleria  
1 Hays Lane  
London  
SE1 2RD  
United Kingdom  
T: +44 (0)207 804 1045  
M: +44 (0)7590 351983  
e: marija.nikolic@uk.pwc.com

## **Appendix 2: Interviewees**

Barclays  
CHAPS Co.  
HSBC  
Nationwide  
Northern Bank  
Office of Fair Trading  
Royal Bank of Scotland  
The Co-operative Bank  
The Payments Council  
UK Payments Administration Ltd  
(formerly APACS)

## **Appendix 3: Glossary of terms**

**ACH**  
Automated Clearing House

**Bacs**  
Bacs Payment Schemes Limited

**CHAPS**  
Clearing House Automated Payment System

**DCA**  
Direct Corporate Access

**EPC**  
European Payments Council

**NICE**  
National Image Cheque Exchange

**OFT**  
Office of Fair Trading

**PSD**  
Payment Services Directive

**PSP**  
Payment Service Provider

**RTGS**  
Real-Time Gross Settlement

**SEPA**  
Single Euro Payments Area

**SIP**  
Single Immediate Payments

**Appendix 4:**  
**Core features of the Faster Payments Service**

Core features of the Faster Payments Service are demonstrated in *Figure A-1 below*.

**Settlement risk management**

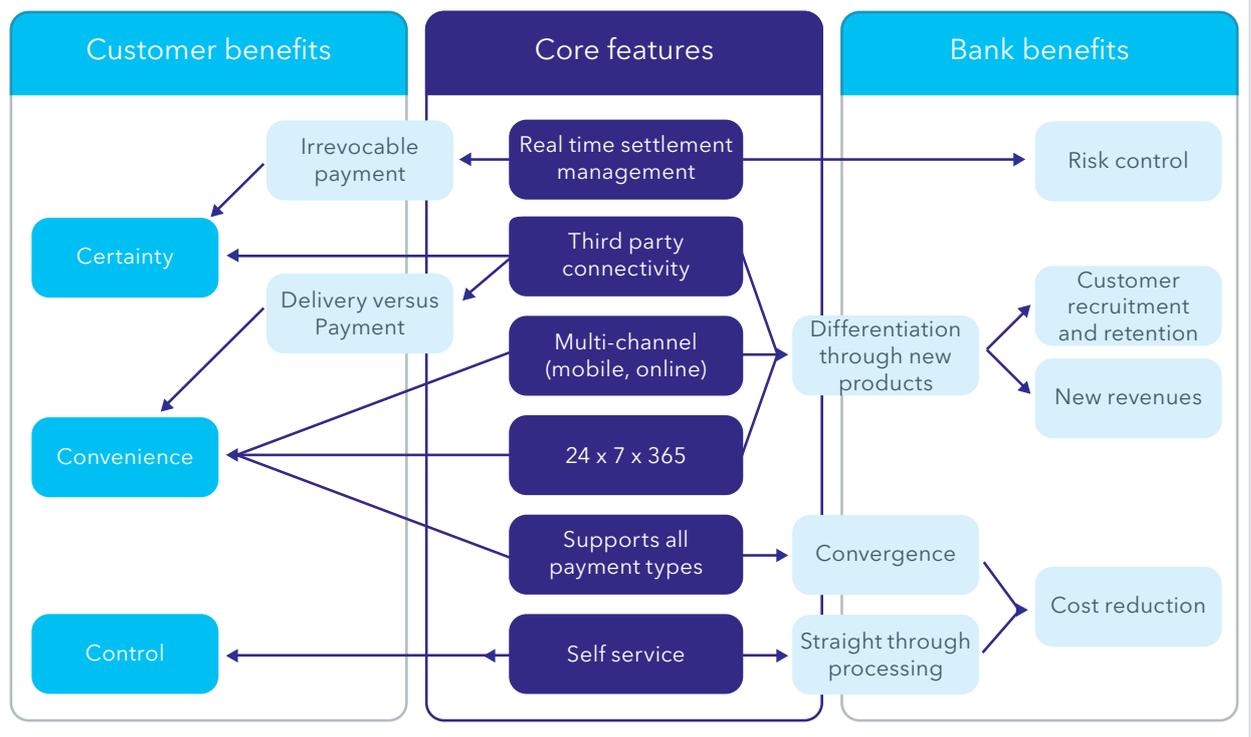
All ACH systems manage counterparty settlement as a core competency. A key requirement for real-time payments is the need for immediate irrevocability (effective finality), so settlement must be contained within limits that remove the possibility of disputes between participating financial institutions after the event. The United Kingdom service manages this through a system of multilateral debit caps for each party in the system. As long as the indebtedness to the system of a party is kept within this limit, the presence of a multilateral loss sharing scheme ensures that any subsequent settlement failure does not affect the validity and finality of payments made. Whilst the obligations between banks are much reduced by the reciprocity in the system, deferred net settlement is carried out three times a (working day) day in the UK in order to

reduce risk. The limits enable the system to be safely deployed 24/7 - if a bank drops below its debit cap customer transactions will fail individually, until such time as the bank's funds are restored within limits - either by settlement or by inbound customer-to-customer transactions.

Whilst the loss-sharing scheme and deferred net settlement arrangements are acceptable within the UK (following the model of Bacs and other schemes) this is not the case in many other countries (and indeed within SEPA) where settlement precedes the release of payment to a customer. The real-time system easily adjusts to such a model and VocaLink's experience beyond the UK has resulted in the development of the settlement risk model to work on a pre-funded basis, loosely described as 'real-time net settlement'. In such a system, a participant bank pledges funds to a nominated account at the responsible central bank. A corresponding credit is made to the bank's limit account within the real-time payments system and used as 'pump priming' to enable the bank to initiate payments up to the value of the initial credit -

**Figure A-1:**  
**Features of the Faster Payments Service**

Benefits which connect everyone



the ongoing balance being maintained through this initial allocation less any payments made on behalf of the bank's customers and any inbound transactions received from other banks. In place of deferred net settlement, a system of regular synchronisations is envisaged to ensure both the operation of central bank connectivity and to maintain balances at a target level for the bank concerned. This approach has several advantages:

- For all transactions it gives real and effective finality, as all transactions are backed by central bank funds. In the case of a bank failure, there will be no consequential call on other banks to support loss sharing, and the real-time central infrastructure will reflect the true accounting position of funds allocated to all participants.
- It is potentially less onerous for new members to join the service, requiring only funds to be deposited to the real-time infrastructure's account at the central bank in their name (the transfer may be effected via a third party, obviating the need for them to hold a central bank account). This may be of particular importance following the implementation of the PSD, and the potential admission of payment institutions to clearings.
- Banks will be able to raise or lower their allocated liquidity, for example to cover weekends and public holidays when central clearing systems are not operational.

### **Third-party connectivity**

Third-party connectivity was designed into the UK Faster Payments Service model from the outset and was intended to leverage the real-time potential of the service. In this model a connected 'responding third party' may be included in the workflow of the payment such that they may approve or reject the payment being made. For example at the simplest level, a customer paying a credit card bill would enter the credit card reference into the Faster Payments Service systems when paying to the card company's collection account. When the payment is received by the central infrastructure the payment is first routed to the credit card

company: if the payment is recognised and approved, the payment is then released to the bank at which the collection account is held. The response to the customer can then include indication that the bill has been paid and that the credit card company itself has acknowledged receipt. The presence of this responding capability lends itself to many 'delivery versus payment' type applications, which is further enabled by the flexibility of the real-time format to accept large amounts of accompanying reference data.

### **Multichannel capability**

Although the Faster Payments Service is an interbank service, its single transaction design gives it the flexibility to support multiple channels from the bank to the customer. This provides the capability to provide a similar customer experience over such diverse channels as internet, call centre, smart phone, branch, operations centre (e.g. for standing orders and other automatically originated payments) and ATM, thus greatly enhancing convenience. The current Payments Council initiative on remote mobile payments demonstrates the potential to enable a new channel with additional features, whilst using standard Faster Payments transactions.

### **24/7 Operation**

24/7 operation has not been the norm within the payments community - except for card payments, ATMs, call centres and online banking. In fact all the areas where development in banking channels has been most intense over the last decade and most reflect modern consumer behaviour in other spheres. Such a feature imposes technical challenges on banks and central infrastructure providers like VocaLink to ensure this level of availability, but this is probably more of an extension from the other domains mentioned above - a kind of convergence of behaviour. 24/7 operation is also enabled by the settlement risk arrangements described above. Within the Faster Payments Service, while core SIPs between bank accounts, primarily aimed at consumers is supported 24/7,

standing orders and business-to-consumer bulk transaction types are supported on working days only. We may see this shift towards more general availability as more businesses move to a 24/7 pattern, particularly in respect of those business that serve consumers 24/7.

### **Support for all payment types**

The UK Faster Payments Service currently supports a range of different payment types - SIPs, which represent the core payments proposition, plus Future Dated Payments (FDPs -largely standing orders), payments with a third-party beneficiary 'leg' and payments received as bulk files from corporates. However all these payments follow the same basic route across the central infrastructure, the different requirements are met by differential workflow determined by the transaction type, access method, destination and potentially a range of other factors.

This workflow effectively builds value-added services into the basic transaction at an atomic level. By extension this enables a real-time service to cater for any potential payment type across the same interbank, infrastructure. Future enhancements could potentially enable:

- A separate settlement 'leg' for very high value payments as a different workflow, enabling the real-time service to be used by banks to access RTGS systems such as CHAPS or Target2
- Cross- currency transactions.

### **Self-service - all parties instantly informed**

A highly significant feature of an end-to-end real-time system is its empowerment of the end customer. Since the service gives an instant, unequivocal answer to the question 'has this payment been delivered?' Once accepted by both paying bank and beneficiary bank, the issue of returns, repairs, recalls and exception management falls away from the bank domain. Whilst this can be seen very positively from a bank perspective, in terms of reduced internal costs (for relatively low value mass payments, the cost of exceptions may be several orders of magnitude greater than the cost of making the

original payment), the end customer experiences levels of certainty and control hitherto unavailable from payment systems. For consumers, this is increasingly an expectation based on experience with online retailers and to some extent met by specialist closed-loop payment service providers. For businesses this opens up significant future potential - a payment made and acknowledged instantly can mean that a particular transaction can be effectively closed, with no further need for tracking or reconciliation. One that fails can be investigated immediately and the situation rectified, before consequential actions compound the cost. On the beneficiary side, receipt can be flagged instantly, and the third party beneficiary model enables that receipt to be instantly identified and processed by its internal system, effectively eliminating the need for post-event batch reconciliation.

### **Faster Payments vs. RTGS**

The market often confuses different concepts of payment proposition, payment clearing and payment settlement. These need to be understood as being different and then understood according to their differences.

Most markets have now implemented RTGS (see *Figure 3, page 20*), but this usually has no bearing on customer payment proposition. In the UK, if a customer wishes to make an urgent payment to another bank (above the limit that can currently be satisfied by the Faster Payments Service, or to a bank that is outside the scheme), then they will typically be offered a solution using the CHAPS (RTGS) scheme. Although the settlement will occur in real-time, the proposition can be better described as 'sometime today and almost certainly for tomorrow'.

Provided a customer meets the required cut-off, agrees to accept the terms and conditions that the payment may place, and can wait until the following day to check for success then all is fine. Many customers seeking an urgent payment in 2009 want something else, and increasingly they expect something better.

RTGS systems are designed to make high-value payments, payments that are systemically important and payments that relate to intrabank settlement. RTGS therefore 'does what it says', and is typically focused on treasury customers.

RTGS does not meet the market need for urgent low-value payments.

### **Faster clearing**

Payment clearing relates to the processes involved in processing an accepted customer payment, exchanging the payment information with the involved external parties, and establishing the settlement requirement to make the payment final. It is therefore a Payment Service Provider to Payment Service Provider concept.

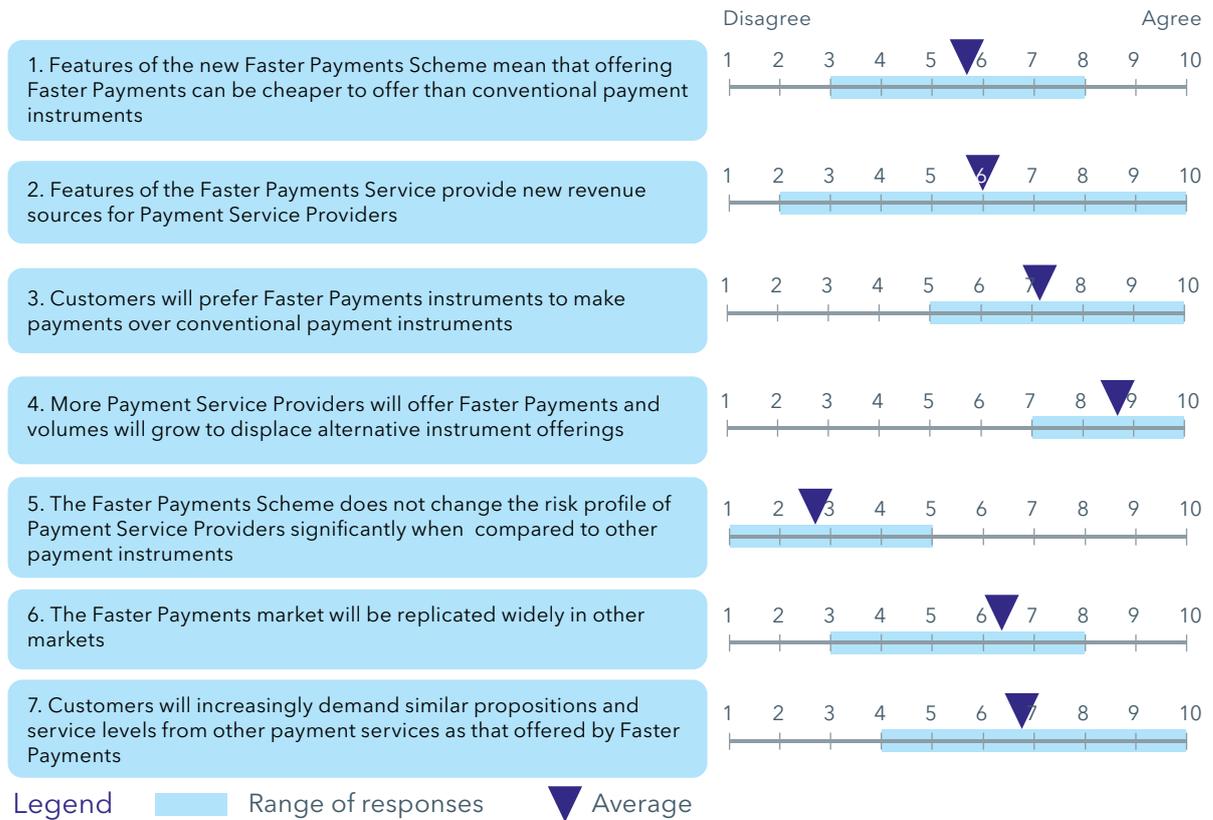
### **Faster Payment propositions - what's in a name?**

The term Faster Payments correctly indicates the basic premise of the proposition, but it does not fully distinguish the proposition from the solution. This makes it harder for providers to sell propositions to customers, since customers will either assume some say in the means of delivery or some relationship between the proposition and the routing as a result.

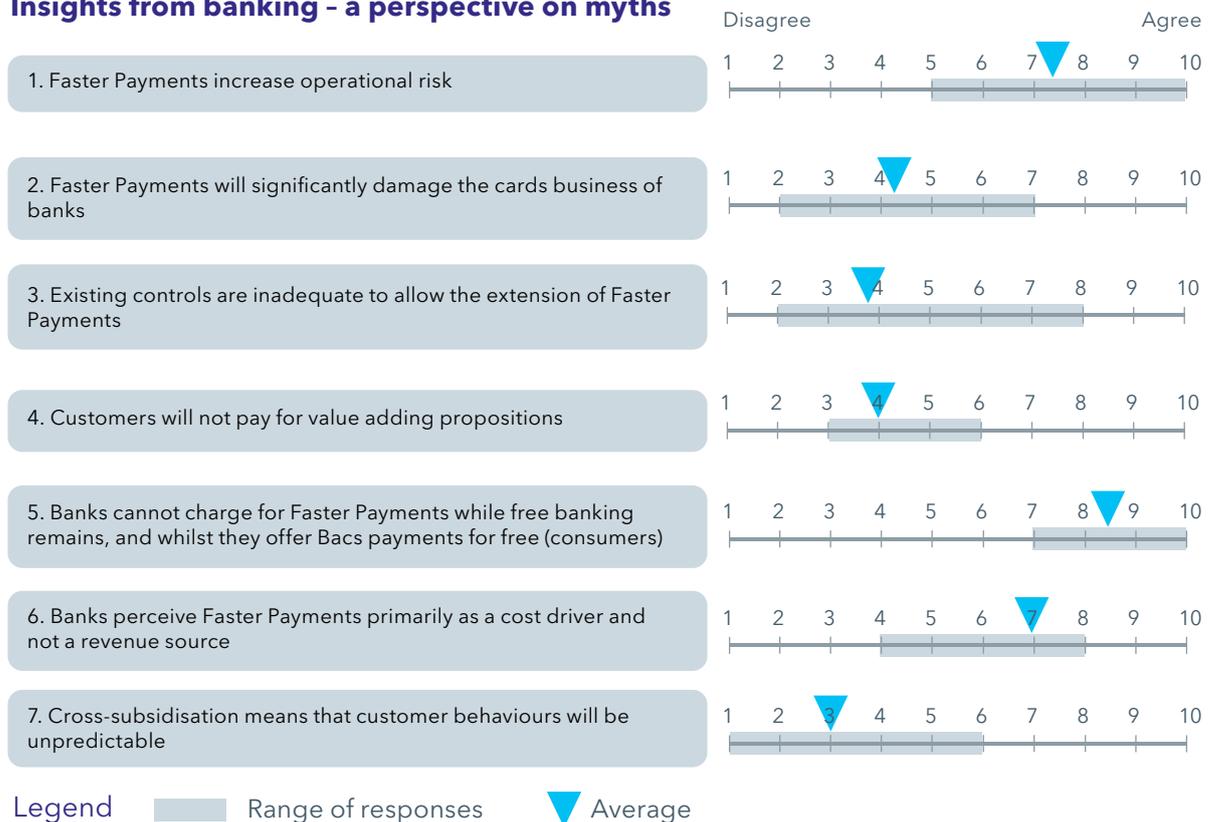
Relationship managers confront this challenge every day. Seeking to address the essential customer needs of payment amount, required time of receipt and beneficiary in the most cost-effective manner possible, they often have to deal with the additional requirement of scheme identification. This can drive needless cost into the solution, which can then be difficult to pass on.

With clearer product development focus during scheme development, the Faster Payments solution might have been better described differently and this would have made its commercialisation easier.

## Appendix 5: Insights from banking - a perspective on hypotheses



## Insights from banking - a perspective on myths





**Attribution of figures**

Figures 1-5, 9, 10-14, 16 and Appendix 5; source: PricewaterhouseCoopers LLP UK.

Figures 6-7, 15, A-1; source: VocaLink.

Figure 8; source: VocaLink and PricewaterhouseCoopers LLP UK.

**Copyright**

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, VocaLink Limited and PricewaterhouseCoopers LLP UK do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2009 VocaLink Limited and PricewaterhouseCoopers LLP UK. All rights reserved.





**VocaLink**

Drake House  
Homestead Road  
Rickmansworth  
WD3 1FX  
United Kingdom

+44 (0)20 7831 4085  
[info@vocalink.com](mailto:info@vocalink.com)  
[www.vocalink.com](http://www.vocalink.com)



**VOCALINK**  
at the heart of payments

**PricewaterhouseCoopers LLP UK**

1 Embankment Place  
London  
WC2N 6RH  
United Kingdom

+44 (0)20 7583 5000  
[www.pwc.co.uk](http://www.pwc.co.uk)  
[www.pwc.com/transactionbanking](http://www.pwc.com/transactionbanking)

**PRICEWATERHOUSECOOPERS** 