Safety and speed are not alternatives

The payments industry is moving towards real-time retail payments systems (RT-RPS) that operate 24/7, 365 days a year. An urgent question is whether there are any boundaries to this apparently unstoppable movement towards instantaneous payment, around-the-clock. One concern is that increased speed might be purchased at the cost of either safety or regulatory compliance, or both. Liz Oakes, associate director at KPMG, argues that the industry has no choice but to ensure that its traditional checks and controls keep pace with what consumers know is technologically possible.

Retail payment systems encompass a wide range of transactions. They facilitate corporate payrolls, consumer-to-consumer, peer-to-peer, government-to-business, business-to-business, consumer-to-government and all points between these counterparties. Within these various categories, volumes are changing and growing, creating familiar problems of volume and control.

Payments are also shifting from the traditional methods of cash and cheque to instantaneous payment via cards, on-line services and mobile devices. As consumers and businesses become accustomed to instant payments by electronic means, these volumes are bound to rise, as both payers and payees appreciate the simplicity, convenience and safety they offer.

The myriad combinations of counterparties, and the burgeoning range of payment methods, have led to differentiation and specialization in products as service providers seek to meet the varying needs of participants in the payments eco-system. But every combination of counterparties and payment methods has two undisputed requirements in common with every other combination. These are the need for better data and the need for speed.

Safety and compliance depend on speed and data

The requirement for speed and the requirement for data are tightly linked. Retail transactions that are executed quickly can easily become a focus of activity for bad actors in the eco-system. Faster payment systems represent a new opportunity for criminals, and protecting their users from them is a fresh challenge for payments market infrastructures.

This is where data counts. The management of the risk of wrongdoing in retail payments has long concentrated on the client on-boarding process, where success depends on Anti-Money Laundering (AML), Know Your Customer (KYC) and (increasingly) Know Your Customer's Customer (KYCC) policies. In other words, payment processing is typically a rules-based environment, where numerous checks and controls are required to protect the overall system from misuse.

These checks and controls take time to apply. It follows that faster payments

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necessitate faster access to the data to conduct the checks and implement the controls. In fact, identity management and data security now have to be managed in real-time. Where speed cannot be slowed down to buy time to make an assessment, credit risk decisions also have to be managed in real-time.

To make decisions at the necessary speed, a number of methods are available. An obvious one is transaction limits. Behaviour profiling is another, and it is already being used successfully to enhance decision-making. It has proved useful both in detecting and reporting potentially fraudulent transactions. But the ideal answer is to invest in systems that identify senders and beneficiaries correctly, and instantaneously, without putting customer data at risk.

In instant payments, the problem is not speed but volume

Paradoxically, speed is not the principal obstacle to meeting this challenge successfully. The real problem is the checks to be made in real-time on the volume of payments as they are made. This problem is more complex when payments are made across borders, and not only because disparate regulatory requirements in different jurisdictions add complexity. Unlike domestic payments, payments across borders were not traditionally processed in a fully automated fashion, so volume is already a problem. Cross-border payments are easier to manage when they are credit-pushed rather than debit-based, but it is still difficult to implement controls when the volume of payments is both high and continuous.

Legacy systems are part of the problem of adaptation. The payments systems at most organizations are designed to distinguish between batch payments and real-time gross payments. Finding space between these binary alternatives to conduct checks and apply controls is difficult. Creating an alternative instant payments processing stream is not a simple task within a legacy architecture whose components were not designed for such a purpose. But any institution which fails to adapt its systems to the new requirements now faces an existential threat.

The threat from new entrants is shifting from channels to disintermediation

Payments are one of the most active targets of disruptive FinTech companies around the world today. A confluence of new technological capabilities centred on the wants and needs of the individual consumer, and an increased regulatory focus on the rights of consumers and the benefits of competition, has created opportunity for new entrants into the payments industry.

Banks, as heavily regulated deposit-taking financial institutions, tend to perceive themselves as being at a competitive disadvantage in this contest to facilitate retail payments transactions. Instant payments impose a real-time processing requirement on organizations that are used to batch and even overnight processing. New entrants, by contrast, are offering not only real-time payment but digital offerings that incorporate richer data and advanced analytics.

This is changing the nature of the competitive threat faced by the incumbents. Until now, competition has revolved around the channels

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used to access bank payment services. As consumers shift to on-demand services, with specific offers based on on-line and off-line profiling and location, the challenge is to build networks capable of joining up both sides of every transaction in real-time. To meet it, innovation focused on the inter-bank mechanisms for retail payments. In the next phase of innovation, there is a risk of banks being disintermediated altogether.

Banks are alive to this threat. However, the business case for investing in the systems necessary to support real-time retail payments is a difficult one for any individual organization to prove. While banks and financial institutions have for many years offered 24/7 products such as automated teller machine (ATM) services and Point of Sale (PoS) card systems, these did not require payment systems to be available on-line and operating 24/7.

The scale of the changes necessary is daunting but unavoidable

Operating in an environment defined by 24/7 real-time market infrastructures, by contrast, necessitates change across almost every aspect of customer interaction, systems and processes. Areas affected include product management, customer channels, customer notifications, accounting platforms, credit decisions, fraud systems, compliance and reporting, funding, and technical integration into multiple 24/7 clearing and settlement platforms.

Change on this scale is daunting. It represents a step-change for payments market infrastructures as well as payments banks. Yet, for any institution wishing to remain in the payments business, the risks involved in not moving to real-time are clear. Equally, moving to instant payments across the entire global payments eco-system creates fresh risks of its own, especially in terms of running checks and implementing controls while managing heavy volumes of payments at high speed. Working out how to manage the risk of shifting an organization to real-time, and then managing the risk of operating in real-time, is the principal challenge facing banks and market infrastructures active in the payments industry today.

Want to find out more?

Real-time: how fast is too fast?

Tuesday 13 October 2015

09.00-09.45 a.m.
Conference room 1

Moderator:

Liz Oakes
Associate director, associate director, KPMG

Panelists:

Karin Flinspach
Head of cash products, transaction banking, Standard Chartered Bank

Hays Littlejohn
CEO, EBA CLEARING

Craig Tillotson
CEO, Faster Payments Scheme Limited

Ather Williams
Head of global transaction services, Bank of America Merrill Lynch

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