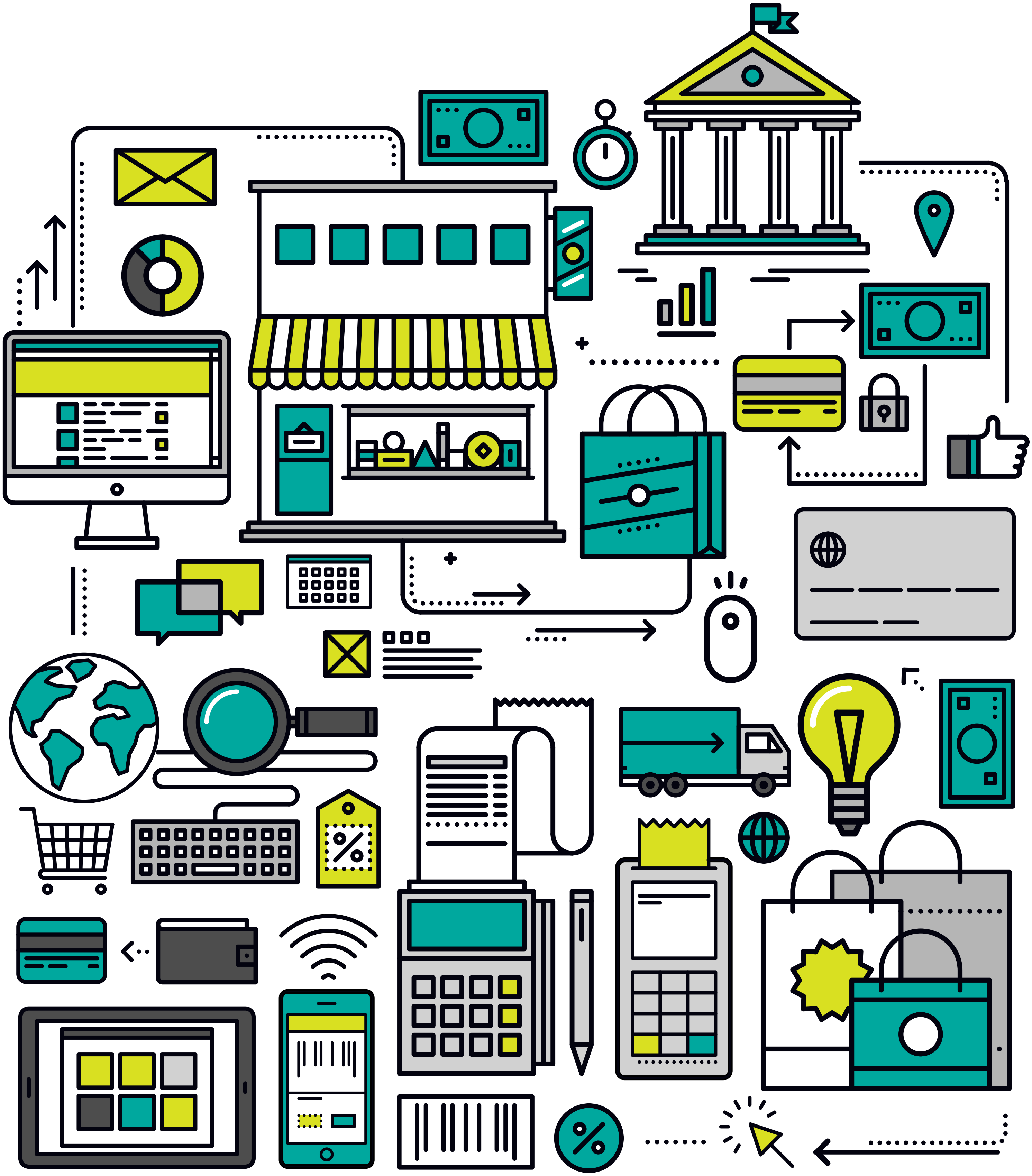


MEANS OF EXCHANGE

Payments technology is fruitful territory for innovation, and new solutions add speed and efficiency, but a genuinely revolutionary approach is some way off. Rebecca Brace looks at developments

Last year, the Payments Council reported that electronic payments had overtaken cash payments in the UK. While cash continued to be used for 48% of transactions, other payment methods – such as debit cards (26%), direct debit (10%) and credit cards (6%) – together represented more than half of transactions. This trend is expected to continue: the Payments Council (relaunched as Payments UK in June 2015) also predicted that by 2024, only 34% of consumer payments will be made in cash.

Meanwhile, the area of payments is evolving rapidly. From mobile payments to blockchain, new technology is reshaping the way that people and businesses transfer money. While some of these developments are already in use, others are more nascent. Innovation is also breathing new life into traditional payment instruments, from the launch of polymer notes to the development of mobile cheque-imaging services.

Embracing revolution

Against this backdrop, to what extent are treasurers taking advantage of the opportunities currently presented by the changing payments landscape?

"From a business perspective, we are seeing corporates reap the benefits from innovations like contactless cards and Faster Payments, especially where they deal with consumers directly," comments Natalie Willems-Rosman, head of payables and receivables, GTS EMEA, Bank of America Merrill Lynch. "However, in general, there is still ground to cover when it comes to both consumers and businesses fully embracing the benefits new technologies have to offer."

Areas of focus include B2B payment systems, while debate continues about the role that distributed technology could play in correspondent banking. In more established developments, treasurers should also be asking whether they can leverage the UK Faster Payments Scheme more effectively.

"There is still ground to cover when it comes to both consumers and businesses fully embracing the benefits new technologies have to offer"

Faster Payments

Launched in 2008, Faster Payments was one of the world's first real-time 24/7 electronic payments schemes. Last year, it processed 1.24 billion payment transactions with a value of £1,104bn.

Mike Banyard, head of development for Faster Payments Scheme Ltd, says there are some interesting use cases for Faster Payments that are driving tangible benefits to businesses and their customers: "From insurance companies seeing a competitive advantage by being able to settle claims immediately (no more waiting for the cheque to arrive) through to consumer-lending firms being able to deliver the proceeds of a loan request within minutes, or firms that are moving to 'just in time' stock management – ordering and paying for goods only when they actually need them," he says.

These advantages are not always fully realised. "For many corporates in the UK, up until now, Faster Payments has mainly been seen as a 'get out of jail' card to play in exceptional circumstances, such as a delay in payroll or supplier payment submissions," says Banyard. "This has been, at least in part, because taking advantage of the immediacy of such payments could require changes in business processes, IT systems and service propositions."

B2B payment systems

B2B payment systems represent another interesting area of development. Carl Sharman, senior director in Deloitte's Financial Advisory practice, notes that there are three types of B2B payment systems:

- Those that replace the traditional role of the bank (ie M-Pesa);
- Those that work with banks to provide a service that banks can offer to their own customers (ie mobile payments and non-financial counterparties, prepaid cards, Faster Payments); and
- Those that use the automated clearing house (ACH) system to process payments (ie supply chain finance multi-bank platforms, such as Orbian and GT Nexus).

According to Sharman, M-Pesa is the benchmark for bank disintermediation. However, he questions whether this scheme has global scale, having evolved to fill a need where the existing bank infrastructure was poor.

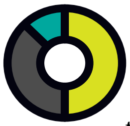
"The fastest growth potential is in supply chain financing intermediaries that facilitate dynamic payments discounting on a large scale through multi-bank platforming, as part of a wider working capital management programme," he says.

"Already some huge multinationals are choosing these platforms over single-bank proprietary systems."

Distributed ledger technology

The possible applications of this technology are certainly interesting. "Distributed ledger has great potential to bring enhanced features to the payments landscape," says Matthew Davies, co-head of product management, GTS EMEA at Bank of America Merrill Lynch. "Some of these include the ability to carry more data and, therefore, make it easier for organisations to reconcile payment information and use data effectively."

Davies adds that distributed ledger technology allows for transactions to be settled more quickly and around the clock, and more easily across geographies. "These features could potentially be very beneficial for corporates and can open up all sorts of opportunities off the back of having real-time payment confirmations across the globe, such as entering new markets."



However, it is important to note that these benefits may not materialise any time soon – despite significant attention given to this topic in the past couple of years. As Willems-Rosman says: "It will take time before we have a clear view of how new technologies, such as blockchain, could be fully embedded in the payments landscape, as the industry is focusing on how they can be delivered in a secure, tested and integrated way."

"Everyone gets very excited about blockchain, but it's interesting to cut through the hype," comments Ruth Wandhöfer, global head regulatory and market strategy, treasury and trade solutions, at Citi. "There are a lot of areas where people are probably under the impression that blockchain technology is already extensively being used in financial services to transfer financial assets. This is really not the case – apart from Bitcoin."

She adds: "Various players in the blockchain space have reassessed their proposition and begun to embed features of this innovative technology,

such as distributed consensus mechanisms, rather than replacing existing financial market infrastructures and processes altogether, for example, in the correspondent banking space."

Gaining ground

Much is changing – but how significant are these new developments compared with traditional payment methods?

Sharman argues that technology such as UK Faster Payments and mobile payments represent evolution rather than revolution. "The same single-ledger banking system applies (ACH) – but these recent developments in technology enhance the customer experience, making it faster and easier to access it," he explains.

"For example, Faster Payments artificially speeds it up, as banks take on the risk through collateralisation. So if a payment fails in the traditional clearing process, the claim is against the bank that has guaranteed it. Hence, there are upper limits on transaction amounts to match the banks' collective appetite for risk."

Sharman notes that mobile and internet systems, such as PayPal and Paym, add a layer of security by attaching email addresses and mobile numbers to bank details, or by using new passwords. This enables consumers to access their accounts in a different way.

"Consumers get better access to their accounts to pay and receive cash, but essentially with upper limits dependent on the risk the new provider(s) is prepared to take," he says.

Blockchain technology, in comparison, offers a genuine revolution by promising a new way of accessing value exchange. However, no system is infallible. What is more, banks "have a very strong

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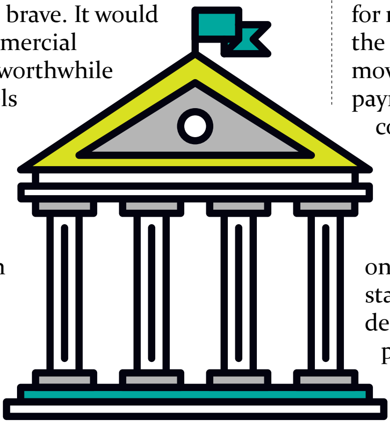
incentive to collaborate" because of the potential costs they could face as a result of disintermediation, Sharman argues.

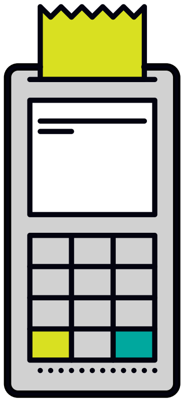
"My hunch is that non-financial applications will lead the way – documentation exchange, for example," says Sharman. "Once these are considered foolproof, the step can be taken towards value exchange. However, early adopters will be brave. It would take a move into commercial payments to make it worthwhile on scale, and the levels of trust needed are huge. And as the cost of accessing traditional (evolutionary) methods erodes, then the touted benefits may be significantly smaller by the time the technology is considered viable."



Regulatory developments

Meanwhile, regulatory developments, such as the revised Payment Services Directive (PSD2) may support further innovation in payments. "PSD2 and changes in interchange fees will further promote change and demand for real-time services – and the PSD2 may support the move away from cards for some types of payment," comments Banyard. "There could also be significant implications for the use of direct debits in future as end users seek greater real-time control over their finances."

The industry is currently working on an enhanced common ISO 20022 standard, which is specifically designed to handle real-time payments, he notes. "This will have a major impact on the speed at which cross-border immediate

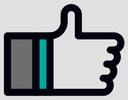


payments will materialise," he says. "Opinions differ on when this will become a reality, but commercial pressures will push this along faster than we might expect, certainly a lot faster than SEPA implementation."

At the same time, the UK's Payment Systems Regulator is currently consulting on draft guidance, which looks at how access is given to certain regulated payment systems. "The consultation is looking at what users want, how access to markets can be improved, whether this needs to be done through collaboration or competition between people, and how best to enable that," explains Shaun Kennedy, group treasurer of Affinity Water. "I think we'll come through this consultation with a definite plan for the UK and hopefully some innovation will come to the fore."

Payments technology is evolving rapidly. Some of the most significant changes currently being developed may take many years to come to fruition. In the meantime, however, there are plenty of opportunities for treasurers to gain a greater understanding of new and recent developments, and explore how these can be used to their advantage.

CUSTOMER CHOICE



Shaun Kennedy, group treasurer of Affinity Water, says the utility offers up all payment methods regardless of how long they have been in use. "It's really important not just to think about people who've got mobiles and are using all the latest gadgets and apps, but also to make sure that the payment systems continue to serve those who don't have access to, or feel comfortable using, the latest technology," he says.

Kennedy notes that there has been a lot of innovation around mobile payments in emerging economies, such as Africa and China, which have skipped ahead of the UK in some ways. "WeChat, for example, is fundamentally a messaging service, but the way people are using that to make payments to each other is really interesting."

For Affinity Water, meanwhile, some of the most interesting developments include those relating to direct debits. "Direct debit has been around for nearly 50 years, but some developments may be happening here, too," says Kennedy. "If I'm a customer who gets paid on an ad hoc basis, you might take the direct debit, but I might not have any money that day – so the direct debit will bounce. One possibility is for the concept of Request to Pay. A company sends me a request for £30 for my water bill that month and I can say: actually, I'm not going to accept it today, but in two days' time, when I know I've got money, I'll release the payment. That idea has been talked about for a while and will hopefully become a reality."

At the same time, the ability to include more detailed information could make it easier for companies to match up incoming payments with the relevant bills. "As a water company, we get payments from lots of people, but we don't always know what those payments are for, because not everyone includes their account reference," Kennedy explains. "The ability to interact more through the payments system would be useful – for example, by allowing customers to send a picture of the water bill alongside the payment. I think it will be interesting to see how that develops going forward."

Rebecca Brace is a freelance journalist specialising in corporate treasury and banking