The changing face of payments
Tim Lambertstock

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Agenda

• What are payments?
• Global payments market
• UK payments landscape
• How things are evolving
• Possible future developments
• Questions
What are payments?

- They are a means of transferring value from one person or business to another
- They drive commerce
- Their key attributes are currency and amount
- They can be in cash, paper-based, plastic card or electronic
- They can be domestic or international
- They can be low-value or high-value
Payment basics

Push payment (credit transfer)

Payer’s Bank \(\xrightarrow{\text{Payment}}\) Clearing system \(\xrightarrow{\text{Settlement}}\) Payee’s Bank

Instruction to pay

Payer \(\xrightarrow{\text{Transaction}}\) Payee

Central Bank

Account Credited with payment
Payment basics

Pull payment (cheque, direct debit, card payment)

- **Payer’s Bank**
  - Debit advice
  - Account debited

- **Clearing system**
  - Settlement

- **Central Bank**
  - Debit request

- **Payer**
  - Transaction (payment agreement)

- **Payee**
  - Request for Payment or cheque

- **Issuer Bank for Cards**
  - [Issuing Bank for Cards]

- **Acquiring Bank for Cards**
  - [Acquiring Bank for Cards]

- **Merchant for Cards**
  - [Merchant for Cards]

- **Cardholder for Cards**
  - [Cardholder for Cards]
Payments infrastructure

- Payments can take place bilaterally (between two Institutions) but, more usually, multilaterally through a Clearing system
- Settlement, through accounts at a central bank, may be Net (Bacs etc) or Gross (CHAPS etc)
- Multilateral payments rely on a set of Scheme rules that bind all participating Institutions
- Direct Debit schemes have a separate set of rules to protect consumers
- Local and, increasingly, international standards are key
Global payments market

• The volume of payments continues to grow, in spite of economic crisis
• But volume of high value payments has fallen
• Debit card payments and electronic payments show biggest growth and cheques biggest decline
• Cards represent over 58% of non-cash transactions
• BRIC countries show the largest growth (28% CAGR)
• But cash use also continues to grow, particularly in the Eurozone (even excluding €200 & €500 notes)
Cash

- Cash is the simplest form of payment and still accounts for the majority of transactions globally
- Very few non-cash payments in Greece, Italy and Poland
- Cash-in-circulation in the Eurozone has maintained a steady growth of about 11% per year since 2002
- This represents a significant cost for global economies (the European Payments Council estimates that the cost of cash payments for European Union economies is €50 billion to €75 billion a year)
- There is thus a business and political imperative to reduce the use of cash
Cheques

- The use of cheques is in decline globally (6% per year), even in the US
- They have already disappeared from some economies (including Scandinavia, Belgium)
- Cheque processing is expensive and there is a high risk of fraud
- Most cheques are used by older people
- Many people under 30 have never written a cheque!
- BUT, cheques are currently the only alternative to cash for some transactions
Cheques in the UK

• Cheque volumes are falling by about 13% per year
• The UK Cheque Guarantee Scheme is currently being phased out and closes on 30\textsuperscript{th} June 2011
• The Payments Council has proposed that the UK Cheque Clearing Scheme should close on 31\textsuperscript{st} October 2018 “provided that adequate alternatives are in place…”
• A final decision will be taken in 2016 and this will be open to public scrutiny
• Cheques could continue after this but there would be no centralised clearing and no obligation to accept cheques
UK electronic payments

- Bacs has been running since 1968 and is one of the first electronic payment systems in the world.
- Bacs supports Credit transfers and Direct Debits plus various payment information transactions.
- Faster Payments was introduced in May 2008 and has grown rapidly.
- CHAPS is used mainly for high-value transactions.
- LINK is the UK ATM scheme that enables cash withdrawals, balance enquiries etc from virtually all UK ATMs. It also has links internationally.
Card schemes

• Most cards are issued under one of the two International Card Schemes – Visa and Mastercard

• They have detailed scheme rules, standards and compliance requirements e.g. 3D Secure, PCI DSS

• Most ATM cards and some debit cards are issued under local schemes although most are co-branded

• Most card processing is now handled by third party processors such as First Data

• Moves to set-up third European Scheme (EAPS)
UK Faster Payments

• Introduced in May 2008

• Allows customers to make faster electronic payments, typically by phone or online banking, to transfer money between accounts or pay bills, or make regular Standing Order payments

• First new payments service to be introduced in the UK for more than 20 years.

• Now used by most UK banks for Standing Orders and phone and online payments

• Each sending bank has its own limits up to the Scheme limit of £100,000 per payment
New non-bank providers are emerging

- The EU Payment Services Directive created a new lightly regulated entity “Payment Institutions” (PIs), allowing non-banks to handle payments and join the banks’ payment schemes and associations
- PIs include
  - Money remitters
  - Retailers
  - Telcos and utilities
  - Internet brokerage
  - Independent ATM deployers (IADs)
  - Prepaid card companies
  - Internet payment companies
  - Bill collection companies
  - Payment technology companies
- These can exploit their existing infrastructure and brands OR be agile, low cost, niche players
New “banks” are also entering the market including:

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<th>Bank</th>
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| PayPal                | Registered as a bank in Luxembourg  
- Leader in online payments  
- Active within the UK Payments Council  
- Particularly interested in mobile space |
| Virgin Money          | Became a bank in 2010 with purchase of Church House Trust  
-Apparently still interested in Northern Rock  
-Will capitalise on brand loyalty and innovation |
| Metro Bank            | New UK retail bank, mainly internet-based, consumer and SME |
| Tesco                 | Now a bank, as well as the leader in customer-centric retailing  
- Potential leader in customer centric banking?  
- Leading the way for other retailers? |
| PayFair               | Launched in Belgium in April 2010  
- Claiming to be the first implementation of the SEPA cards framework  
- Significant interest from retailers, even banks  
- Looking to come to the UK |
New payments market entrants

• New market entrants will operate differently
  – Think in pan-regional and global terms rather than domestic
  – Achieve high-levels of personalisation for customers
  – Appeal to the younger, convenience-oriented customers

• Some will bypass banks completely

• Some will not access clearing & settlement systems

• Banks may not yet have fully understood the change that is happening before their very eyes
The future

- Online and mobile are key to the future
- PayPal and cards largely have the online space
- Mobile is still a turf war (banks, operators and new entrants)
- Near Field Communication (NFC) is the most important development in mobile
- Smartphone apps are making it possible to improve the mobile payment experience
- Security is still a big concern!
- As already seen in the UK, use of cash will fall and be replaced by cards and mobile
Questions?