

# The power of instant payments



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## Traditional correspondent banking model

International payments have historically stayed in the domain of correspondent banks. They leverage their own domestic scheme access, established Nostro/Vostro correspondents and services, while working with established international banking partners along with Swift in the design and administration of secure financial messaging and standards. This is reflected in the membership and participation of most Real-time Gross Settlement (RTGS) clearing systems – in the UK, the bulk of the 37 direct participants in CHAPS<sup>1</sup> are domestic, international and custody banks. Indirect access, when provided by those direct members, extends to thousands more correspondent and indirect participants. This model is replicated the world over.

The range of non-bank, non-traditional payment service providers has grown exponentially over the last fifteen years. The key commonality among traditional and new entrants is their provision of services to underlying clients (and their

clients) by providing access to one or more clearing systems directly or indirectly. Increasingly, Payment Service Providers (PSPs) are looking at Immediate Payments or Automated Clearing House (ACH) access as an alternative to RTGS flow. In the UK, of the 41 direct participants of the Faster Payments Service (FPS) – the UK'S Immediate Payment service – as well as domestic and international banks, PSPs such as Wise, Modulr, Revolut and Mettle are amongst the newer members<sup>2</sup>.

There is a disconnect in the experience of the domestic versus international payments. There are several components that add to their complexity;

- Fragmented and varied formats,
- Different jurisdictional regulation and requirements,
- Payment formatting,
- Compliance checks,
- Funding,
- Liquidity,
- And other practical considerations such as time differences, operating hours and often complex transaction chains.



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## FSB Roadmap challenges / quantitative targets for 2027

When looking at the challenges of cross border payments, the Financial Stability Board (FSB) identified that same disconnect. In coordination with the Committee on Payments and Market Infrastructures (CPMI), the FSB's roadmap articulates the four areas where we are increasingly focusing our attention.



### 1. Cost

There are several elements – the direct cost to customers for making an international payment, correspondent charges either direct (for the use of a Nostro in making payments) or indirect (when charges are either applied or charged back during the transaction lifecycle). Straight-through processing can reduce the costs and can be used in negotiation with correspondent banking partners over fees and deduction, but indirect interbank charges, which can vary by the corridor, currency, and size of a transaction, are harder to influence. The next step is to look at Immediate Payment solutions cross-border to eliminate deductions from the value of the transaction and correspondent banking lifting fees charged back. With the FSB's retail target of the global average cost to be no more than 1% in 2027, this needs to be a priority area of focus.



### 2. Speed

As a Swift gpi member, we are seeing some impressive delivery time frames in our overall statistics with 67% being credited to beneficiaries in 5 minutes, 83% in 2 hours and 98% in 24 hours. None of our outbound international flow is yet via an immediate scheme.



### 3. Access

Through Lloyds Bank Gem<sup>®</sup> we can now offer our Corporate and Institutional clients an omnichannel experience that encompasses Swift MT and MX as well as API data exchange in a secure environment. On our retail and commercial side, we now have 19.8m digitally active users ensuring we can support both FSB targets: first, for Financial Institutions to have at least one option and, where appropriate, multiple options, and second, for all Retail end-users to have at least one option for sending or receiving cross-border electronic payments.



### 4. Transparency

This should cover all elements of the transaction – clarity on data required for the payment, clear signposting of any pre-validation, the amount processed, a breakdown of costs, currency conversion FX rate if applicable, as well as the transaction journey and the time taken to reach the beneficiary.



## Driving forces for change?

### Changing regulatory landscape

The UK Government has clearly articulated its vision for a payments sector at the forefront of technology and innovation<sup>3</sup> and it goes further in identifying four priority areas.

- Equipping Faster Payments for the future, supported by the New Payments Architecture
- Further unlocking Open Banking enabled payments
- Enhancing cross-border payments to make and receive them seamlessly, quickly and cheaply
- Future-proofing the legislative and regulatory framework for payments to ensure it promotes and fosters innovation



The payments industry is also going through a significant and mandatory Swift standards migration from the current incumbent to ISO 20022. This year we have successfully migrated both Target2 and CHAPS to ISO 20022, as well as beginning the CBPR+ industry-wide migration. One of the key benefits of the new financial services messaging standards is increased interoperability – especially as RTGS and Immediate Payments schemes migrate to them.

### Consumer demand and changing expectations

The significant change to our clients' expectations has been brought about by increased digitisation. One of the most immediate responses to the COVID-19 pandemic was the move away from physical cash to electronic and socially distanced means of payments. According to ACI research, as the pandemic accelerated the shift to digital, real-time payments grew 41% in 2020 compared with the previous year<sup>4</sup>.



In a world where immediate real-time access to anything from train travel to news and shopping with same-day delivery becoming standard, traditional payment methods can appear slow and unwieldy. The availability of enhanced information also makes FX rates and spreads more readily accessible to all types of consumers and businesses. So, in the domestic and international e-payments space, expectations for traceability, transparency and timeliness are increasing.

### Competitive landscape

According to the Boston Consulting Group, payments-focused businesses account for about 20% of Fintech launches and funding globally<sup>5</sup> – so are they driving banks out of international payments? Not necessarily; banks continue to play a role in the provision of secure, safe transactions both directly to their customers and to those intermediaries who often rely on them to provide clearing access. The combined forces of Open Banking, PSD, as well as the rapid adoption of APIs in financial services, provide the opportunity for banks to build and partner to provide greater choice, efficiencies and new propositions to their clients.

Increased globalisation, the internet of things, increased mobility of goods and services, capital and people have all contributed to the growing economic importance of international payments. The Boston Consulting Group estimates that the value of international payments will grow to over \$250 trillion by 2027.



## Real-time payments attributes

- They have immediacy of payment to a beneficiary account/confirmation of transaction status
- Charges are not deducted from the transaction value
- Operate 24/7 (or close to)
- Newer schemes are using ISO 20022 which gives data richness and introduces interoperability for cross-border flow
- Increasingly being created and improved because of close cooperation between regulators and the financial industry
- Typically, domestic in nature
- Have a fixed value threshold

## Rise of real-time payments

Real-time payments grew globally by over 63% in 2022, totalling 195 billion transactions, with India and Brazil accounting for over 60% of global volumes<sup>6</sup>. The Faster Payments Service (FPS), the UK's Sterling Immediate Payments service, has been in existence for over a decade. In 2022 we saw prolific growth in payment volume and value. Faster Payments broke the previous year's records again with 3.9 billion payments processed in the year, an annual increase of 15%. Over £3.2 trillion was transferred in 2022, a value increase of 25%<sup>7</sup>.

We have also seen continued efforts to realise access to immediate payments for cross-border flow:

- In the UK and India, Swift gpi members banks can offer Swift gpi tracking for cross-border immediate payments flow
- The European Payments Council (EPC) has published the Europe One-Leg Out Instant Credit Transfer (OCT Inst) scheme rulebook allowing payments coming from out of the Eurozone to be processed instantly in the Eurozone
- The Immediate Cross-Border Payments (IXB) pilot for USD/EUR flow from The Clearing House, EBA and Swift
- Swift Go industry collaboration for low-value payments

Among each of these – similar themes are emerging:

Collaboration and cooperation are key for both clearing schemes, their member banks and Swift to design, pilot and prove concepts. In the recent Iberpay pilot of the new OCT Instant Schema Iberpay the Spanish Payment Market Infrastructure, Swift, the Spanish banks Santander, BBVA and Caixabank, and four international banks, Itau, ANZ, NAB and Lloyds Bank, worked closely together to pilot cross-border instant EUR payments with Iberpay acting as an intermediary to update the Swift gpi Tracker.

ISO 20022 is providing an interoperable standard for banks to work towards. In the UK, the New Payments Architecture will align the FPS to an ISO 20022 standard from its current ISO 8583 standard and will migrate in the next two years. Increasingly the quality of data in the transaction will determine the level of friction and immediate processing.

Swift gpi Tracking – we have already come a long way and are seeing better behaviours in RTGS flow through visibility and the Swift KPI publication that specifically looks at:

- Transactions processed same day
- Transaction traceability
- Transparency of deductions
- Unaltered remittance information

The Swift statistics are evidencing the improved speed of end-to-end transaction delivery. Nearly 50% of gpi payments are credited to end beneficiaries within 30 minutes, 40% in under 5 minutes, and almost 100% of gpi payments are credited within 24 hours<sup>8</sup>. Since Lloyds Bank went live with Swift gpi tracking of our cross-border FPS we have seen end beneficiary crediting in less than a minute.

Lloyds Bank's cross-border FPS solution – enabling cross-border access to Faster Payments – allows international financial institutions to offer an enhanced GBP offering to their customers. This could range from expat solutions to pay a credit card or mortgage, a commercial GBP immediate invoice settlement solution, or enhanced means building up new working capital relationships.

There are a number of key considerations in offering real-time payments to your customers – which currency corridors, how you make your customer experience as transparent and friction-light as possible and how you can best prepare your operation for enhanced end-to-end transaction flows. Be it in native ISO 20022 message generation, enhanced pre-validation, the extension of gpi tracking to Immediate Payments schemes, eliminating or reducing friction is a job for us all.

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- 1 CHAPS, Bank of England
  - 2 Payment system participant list, Pay.UK
  - 3 HMT Payments Landscape Review – The Government's Response October 2021 (Page 3)
  - 4 Global Real-time Payments Transaction Surge 41 Percent 2020, ACI Worldwide (viewed 21/12/21)
  - 5 Global Payments Report 2022 | Boston Consulting Group
  - 6 Prime Time for Real-Time Global Payments Report, ACI Worldwide
  - 7 Faster Payments System statistics, Pay.UK
  - 8 The digital transformation of cross-border payments, Swift



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