Analysis

Payments becoming increasingly real time and less visible

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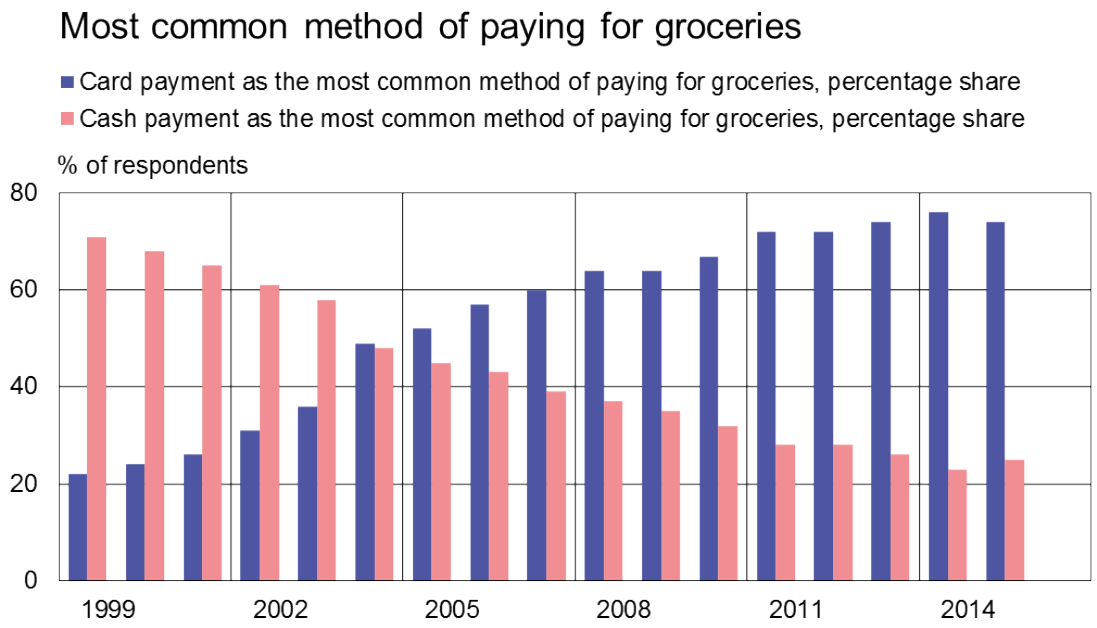
New players and practices are taking hold of the payments market. In Europe, these developments are also being driven by legislative amendments, with the revised Payment Services Directive entering into force in 2018. The three key trends in payments are fragmentation of the market, payments going real time and the actual act of payment fading into the background of the process. Amid these changes, the central bank has the task of ensuring reliable and secure payments also in the future.



Digitalisation is strongly modifying many sectors of the economy, and the financial sector is no exception. A host of FinTech players have already entered or are about to enter the market to compete with traditional financial service providers. In addition to new agile FinTech companies, global internet giants marketing their own financial services are narrowing the playing field for established providers. The common aim of both of these new types of entrant to the financial markets is to deliver as pleasant and effortless a customer experience as possible. Ease of use, 24/7 availability and real-time payment are the hallmarks of tomorrow's financial services.

The act of payment represents an essential element of nearly all financial services. It is also exposed to the pressures for change brought by digitalisation. This is clearly revealed by Finnish payments statistics (Chart 1). In Finland, as in the other Nordic countries in general, electronic methods of payment have rapidly gained ground over the past few years. Card payment is currently the most common method of payment, and credit transfer is also widely used.

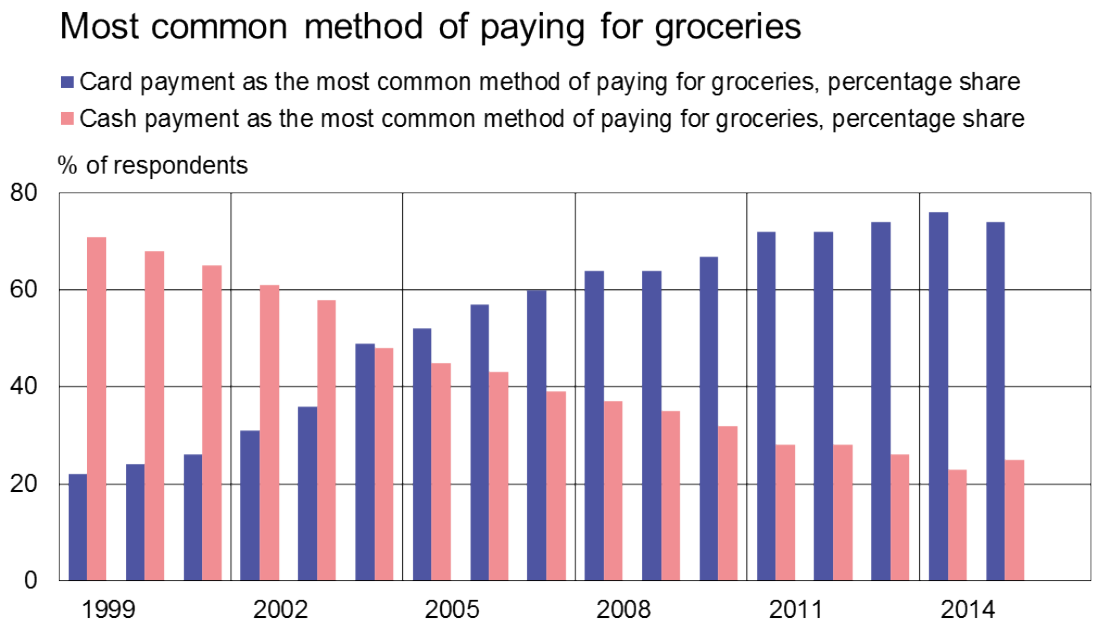
Chart 1.



Source: Federation of Finnish Financial Services.
20 April 2017
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In step with electronic methods of payment gaining prominence, cash withdrawals have decreased. Although there are no absolutely reliable statistics available on the use of cash, the assumption is that cash usage in general has also been on the decline (Chart 2). This is partly related to the introduction of new payment applications, such as contactless payment by flashing the card at the payment terminal, and person-to-person (P2P) mobile payment using the recipient's phone number. Still, we do not anticipate that cash will disappear from the payments market, at least not in the immediate years ahead.

Chart 2.



Source: Federation of Finnish Financial Services.
20 April 2017
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Effects of digitalisation on payments

Payments and the use of different methods of payment are influenced by the mega trends and drivers of change at work in society as a whole. Digitalisation has already strongly modified traditional practices in many different fields, and, for example, travel bookings and music shopping have largely moved online. This change in customer behaviour has turned traditional practices in these sectors completely on their head.

Similar development paths are also possible on the payments scene. When the expectations and habits of payment end-users – consumers, businesses and government – change, the requirements attaching to payment methods and their features follow suit.

The expectations and predictions about future methods of payment are examined in depth in an e-book entitled *'How do we pay in the 2020s? Perspectives on future payment solutions,* prepared in a project within the auspices of the Bank of Finland's Payments Council.[1] The book is a collection of brief articles by various payment stakeholders (users and providers of services and the authorities), presenting their views on the future landscape of payments. In conclusion, the book identifies the following three key trends on the payments scene:

1) fragmentation of the payments market as new players enter the scene;

2) payments going real time;

3) invisible payments seamlessly fading into the background of the purchasing process.

Fragmentation of the payments market

The fragmentation of the payments market is reflected in the multitude of payment applications already available on the market and in a steady flow of newcomers, with mobile payment applications in particular having taken huge strides forward recently.

On one hand, the new payment applications foster competition on the market and increase the freedom of choice of consumers, merchants and businesses, while, on the other hand, the fragmentation of the market also involves some challenges, for example in regard to what new methods of payment consumers should embrace and merchants accept.

The network structure of the payments market has a strong bearing on the choice of payment method. To prevail, a new method of payment must be adopted by consumers, merchants and businesses alike. The more users a payment method attracts, the more willing merchants and businesses are to adopt it. Hence, the fragmentation of the market is expected to decrease over time and the host of payment options in consumers' wallets and mobile devices and in the payment terminals of merchants and businesses be reduced to a few popular tools.

We should also note that fragmentation has to date mainly been a concern of the market for payment applications rather than the underlying payment systems. Consequently, payment innovations have, as a rule, consisted of facilitating applications used to initiate payment transactions.

The payment systems used for executing payments have not changed much so far. Mostly, card payments and credit transfers still run in the background of the new payment applications. There are several different initiatives underway exploring the applicability of new technologies, including block chain technology, to the modification of payment systems. However, no major breakthroughs have been seen so far.

Payments going real time

Real-time transfer is the second recent key trend in the field of payments. The requirement of real-time payment also touches on the general expectations entertained in the digital era of 24/7 service availability without any interruptions due to weekends or holidays.

Systems supporting real-time transfer of payments have been in use for some time already in

certain countries (including Sweden, Denmark, Poland, the United Kingdom and Mexico), and the Euro Retail Payments Board (ERPB) has also worked towards the aim of introducing pan-European instant payment solutions in November 2017. Work on Europe-wide real-time payment solutions is currently in progress and, for example, EBA Clearing aims to launch its own solution on the market towards the end of the year.

At the beginning of March 2017, a real-time mobile payment system was also launched in Finland. This new *Siirto* application provides for real-time mobile transfers between banks. The general impression is that some kind of real-time payment solution will inevitably appear on the market in nearly every corner of the world.

Seamless integration of payments with the purchase transaction

The act of payment fading into the background of the purchase transaction is the third key – and strengthening – trend in payments. This will of course make purchases easier and more convenient for consumers, who will, for example, need to submit payment card details to the service provider only once, after which purchases will be automatically charged to the card without a separate payment instruction.

While better service availability and greater ease and convenience of purchases are positive developments, as such, we must also ensure that the IT security solutions of payment service providers are of a sufficiently high standard. In addition, the payment fading into the background of the purchase transaction may, in the worst case, blur consumers' awareness and understanding of their budgetary constraints. To put it somewhat pointedly, running out of banknotes in the wallet will no longer act as a physical constraint. Easy-to-use and hidden payments underscores the need for embracing new financial literacy in the digital era.[2]

Impact of legislative changes on payments

Obviously, the evolving future of the payments market is also determined by changes in legislation, as well as by the mega trends in payments. Revision of the Payment Services Directive (Second Payment Services Directive, PSD2) has been the major payments-related legislative initiative in the EU. PSD2 must be transposed into national law by 13 January 2018 and will be supplemented by technical standards and guidelines issued by the European Banking Authority (EBA). The aim of the Directive is to extend regulatory coverage to a broader range of payment services and bring regulations on payment services more in line with actual market developments.

The amended legislation defines the boundaries of the payments landscape and formulates rules of conduct for both established providers and new entrants. The key amendments in the Second Payment Services Directive include extension of the scope of regulation and supervision to cover Third Party Providers (Payment Initiation Service Providers (PIS) and Account Information Service Providers (AIS)) and open banking access through Application Programming Interfaces (APIs), which means that account-servicing banks must provide Third Party Providers with access to customer accounts, subject to the customer's consent. The Directive also requires application of strong customer authentication when the customer initiates an electronic payment transaction and accesses the payment account online.

Overall, the entry into force of the Second Payment Services Directive is expected to shape the payments market in that the new entrants will boost competition. This will force all payment service providers –incumbent as well as new – to improve their own services to meet the requirements of the digital era. Services will have to be easy to use, effortless and reliable.

Whether or not the different players will be successful in achieving this, and how the payments market will evolve will only be seen in the years following the entry into force of the legislation. Even now the market has shown signs of increasing cooperation between established providers and new entrants. This is likely to be to their mutual benefit.

The Bank of Finland's roles

In its capacity as the authority responsible for payment system oversight,[3] the Bank of Finland monitors and carefully analyses developments on the payments market. Regular oversight assessments are conducted of systemically important payment systems, whether already in operation or about to start, either at national level or jointly within the Eurosystem.[4] The purpose is to ensure the reliable and secure functioning of the systems under all circumstances.

In its role as catalyst, the Bank of Finland seeks to promote market development to ensure the availability of reliable and efficient payment solutions for Finnish society as a whole. This work is partly undertaken within the Payments Council under the Bank's leadership. The Payments Council is a national cooperation body tasked to develop retail payments, bringing together users and providers of payment services and the authorities. It analyses and assesses changes in the operating environment, current payment initiatives and the impact of regulation.

The digitalisation-driven transformation of the payments landscape highlights the importance of open dialogue and exchange of ideas between stakeholders. The reliability, security and efficiency of payment systems will ultimately depend on the smooth cooperation of all the links in the payment chain.

Notes

1. See https://www.suomenpankki.fi/en/money-and-payments/payment-systems/the-bank-of-finland-as-catalyst-payments-council/. ↑
2. The digitalisation-driven developments on the financial markets also challenge the financial literacy of consumers through other channels. With new players and regimes entering the scene, a major expansion has been witnessed in recent years in the supply of consumer credit to include non-bank providers of credit, and consumers may remain unaware of the differences between – and risks of – individual regimes. For a more detailed analysis, see Kimmo Koskinen and Olli Tuomikoski's article 'The overall picture of debt accumulation gets blurred as provision of consumer credit becomes diversified'. ↑
3. For further information, see Heli Snellman's article 'Payments must be smooth under all circumstances']. ↑
4. For further information on the systems in use in Finland, see https://www.suomenpankki.fi/globalassets/en/financial-stability/oversight/infrastructure-critical-to-the-finnish-financial-markets-20170505.pdf. ↑

Keywords

payment systems, payments