

Deflation of Payments Float

CORPORATE BANKING IN AN ERA OF INSTANT PAYMENTS

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INTRODUCTION

According to the European Payments Council SEPA Inst Rule Book, an 'instant' is 10 secs; ^[1]

The simplicity of the statement belies the paradigm shift that is sweeping across the banking industry. And it's not about the '10 secs', but about a shift in perspective – A radical change in the way financial institutions have been thinking about service delivery. Banks can no longer lumber desultorily as traditional barriers are breaking down and technology is moving at exponential speeds. While customer expectations are at the very center of this revolution, a host of technological innovations have rippled through the retail banking landscape, changing it forever.

And of all the triumphant strides the banking Industry has made, Instant Payments stands out. It has penetrated the very essence of banking - the idea of moving money from one place to another, at a faster pace and lower cost, it has therefore had the most impact on the banking industry.

Corporates can no longer stay immune to the change, as they are propelled by evolving technology that brings with it the promise of cost reduction and operational optimization. And the proof-of-life lies in its success in the large scale retail base.

Conventional definitions of scale and complexity have converged into hyper scale businesses. Today, corporate value outcomes stretch across myriad entities in a hyper-connected business ecosystem; "Why should my experience with the banking system change when I avail its services as a business and not as an individual" sums up the angst of the hyper connected corporate consumer.

The idea of Instant payments is not new. It has been around for some time, in various forms, as shown below ^[2].

General information on existing fast payment implementations in CPMI countries¹

Table A

| Country | Implementation | Adapted/ built ² | Year ³ | Payee speed ⁴ | Service operator | Regulator |
|----------------|--|--------------------------------|-------------------|---------------------------------------|---|--|
| Korea | Electronic Banking System (EBS) | A | 2001 | 1–2 seconds | Korea Fair Trading Commission (KFTC) | Bank of Korea |
| South Africa | Real-Time Clearing (RTC) | A | 2006 | 0–60 seconds | BankservAfrica | South African Reserve Bank |
| Korea | CD/ATM System | A | 2007 ⁵ | 1–2 seconds | KFTC | Bank of Korea |
| United Kingdom | Faster Payments Service (FPS) | B | 2008 | 0–120 seconds | Faster Payments Scheme Ltd (FPSL) | Bank of England and Payment Systems Regulator |
| China | Internet Banking Payment System (IBPS) | B | 2010 | 0–20 seconds | People's Bank of China | People's Bank of China |
| India | Immediate Payment Service (IMPS) | B | 2010 | 0–30 seconds | National Payments Corporation of India (NPCI) | Reserve Bank of India |
| Sweden | BIR/Swish | B | 2012 | 1–2 seconds | Bankgirot | Finansinspektionen |
| Turkey | BKM Express | B | 2013 | 0–30 seconds | BKM | Central Bank of the Republic of Turkey and Banking Regulation and Supervision Agency |
| Italy | Jiffy – Cash in a flash (Jiffy) | B | 2014 | 2–3 seconds | SIA | Bank of Italy |
| Singapore | Fast And Secure Transfers (FAST) | B | 2014 | Approximately 15 seconds ⁶ | Banking Computer Services Pte Ltd | Monetary Authority of Singapore |
| Switzerland | Twint ⁷ | B | 2015 | 2–3 seconds | Twint | FINMA |
| Mexico | SPEI | A | 2015 ⁸ | 0–60 seconds ⁹ | Bank of Mexico | Bank of Mexico |

¹ Tables in this annex include initiatives that meet the definition of fast payment implementation in this report (see Section 2.1 for the definition). ² A: existing system adapted or upgraded for fast payments; B: newly built system for fast payments. ³ This year refers to the year at which an implementation provided full fast payment functionality, including near-24/7 service availability. ⁴ Typical time between payment initiation and availability of funds to the payee for a successful transaction. ⁵ The CD/ATM System has provided near-real-time payments since 1988 with operations on a near-24/7 basis (00:05–23:55) since 2007. ⁶ This is the estimated timing between initiating and receiving banks for a successful FAST transaction, and not an end-to-end timing from the payee's perspective. ⁷ At the time of publication, the two providers offering fast payment services in Switzerland – Twint and Paymit – were in a merging process. Post-merger specifications of the new service (expected to be called Twint) had not been published. All references to Twint, thus, reflect the state of the Twint and/or Paymit service as of end-September 2016. ⁸ The SPEI began conducting near-real-time payments in 2004 with operations on a 21/7 basis for mobile payments since March 2015 and on a 24/7 basis since November 2015. ⁹ 0–15 seconds for mobile payments; 0–60 seconds for other online payments.

When viewed from the prism of emerging technologies and changing user expectations, the concept as it stands today completely reimagines banking service experience in its entirety.

The standardization of ISO 20022 and the flexibility of the open APIs and potential of PSD2 regulations is setting the stage for a new service paradigm in the banking industry



This paper explores the manifestation of Instant payments, as a real time processing engine, into the world of corporate businesses, defined by credit cycles and cash management, balanced sheet provisions and working capital and reconciliation struggles.

Corporate banking, with its big numbers, complex documentation and intricate legalese have always espoused prudence over agility. And with good reason as mistakes can be costly.

Yet, corporates are warming up to the idea of agility and real-time processing and the promise it holds in the previously overlooked area of B2B payments

Prompt visibility of payment status and faster availability of good funds to the payee, makes for a compelling case for corporates to take advantage of reduced float and effectively manage liquidity. It provides flexibility to its corporate customer to practice just-in-time cash management.

And the banking Industry, especially the corporate banking vertical, had to grudgingly admit that ISO 20022 is a competitive threat, as much as it standardizes the interoperability in the Industry, it also allows the corporate clients that much flexibility to switch it's bank.

Corporate banks are no longer left with a choice, but have to transform and upgrade, or risk losing their corporate clients. And the threat is real.

The phenomenon of Instant Payment, shows no sign of diminishing, as it sweeps across the financial markets [2] of the world heralding a new normal in payments

Summary information on proposed fast payment implementations in CPMI countries¹ Table F

| Country/region | Implementation | Adapted or built ² | Year ³ | Proposed access channels | | | | Proposed addressing functionality | | | Proposed inter-PSP settlement model |
|----------------|--|-------------------------------|-------------------|--------------------------|---------------------|--------------------------------|-------|-----------------------------------|---------------------|-------|-------------------------------------|
| | | | | Online ⁴ | Mobile ⁵ | Physical channels ⁶ | Other | Bank account number | Mobile phone number | Other | |
| Australia | New Payments Platform (NPP) | B | 2017 | ✓ | ✓ | | | ✓ | ✓ | | Real-time |
| SEPA | Various implementations based on SEPA Credit Transfer instant (SCTinst) scheme including | | 2017 | TBD | TBD | TBD | TBD | TBD | TBD | TBD | TBD |
| Netherlands | Instant Payments | B | 2019 | ✓ | ✓ | | | TBD | TBD | TBD | Deferred net |
| Belgium | Instant Payments | B | TBD | TBD | TBD | TBD | TBD | TBD | TBD | TBD | Deferred net |
| Saudi Arabia | Future Ready ACH (FR-ACH) | B | 2017/18 | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | Deferred net |
| Hong Kong SAR | TBD (name to be determined later) | B | 2018 | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | Real-time |
| Japan | Zengin Data Telecommunication System | A | 2018 | ✓ | ✓ | ✓ | | ✓ | TBD | | Deferred net |
| United States | TBD | TBD | TBD | TBD | TBD | TBD | TBD | TBD | TBD | TBD | TBD |

¹ Throughout this table, TBD refers to details of a fast payment implementation that have not been finalised by stakeholders and authorities. ² A: existing system adapted or upgraded for fast payments; B: newly built system for fast payments. ³ This year refers to the proposed year of implementation. ⁴ Online includes traditional, often static home or office computer devices that access online banking services via the internet. ⁵ Mobile includes mobile banking, mobile wallets and mobile payments, which can be made using SMSs, USSDs or apps. ⁶ Physical channels include, for instance, bank branches, ATMs and banking agents.

Can the corporate banks afford to ignore the promise of real-time processing?

REAL-TIME PAYMENTS

An interbank account-to-account payment that is posted to the receiver and confirmed to the sender within seconds, is a real-time immediate payment, also referred to as Instant Payment, faster payment

Some common characteristics of real-time payments, across the world are:

1. *24X7 Availability*

A bank consumer can make or receive payments, any time, in its true sense

2. *Real-time liquidity*

Funds can be transferred in real-time, allows faster availability of good fund, and provides visibility where the payments are within the network, at any point of time

3. *Predictability*

Both the payer and the recipient are notified in real-time, that the payment has been accepted or rejected by the recipient's bank

4. *Richer data standards: ISO 20022*

Most real-time payment schemes across the world operate in an eco-system defined by standardized data sets to encourage greater interoperability and to carry richer information with the payment. ISO 20022 is increasingly becoming the standard for payment processing

ACCRUING THE BENEFITS OF REAL-TIME FLOAT

The corporate buy-in for real-time banking stems from the potential that this technology promises and the possibility alleviating operational inefficiencies of the corporate treasury – especially in managing the 'float'.

Float is money in the banking system that is counted twice, for a brief period of time, because of inefficiencies in the collection system. It distorts the measurement of the money supply.

Frees up working Capital

Real-time payments open up the possibility for corporates to hold funds until payments are made (minimizing the float), thereby increasing the amount of available liquidity. The immediacy of the payment provides visibility of the good funds at the disposal of both the parties in the transaction. It empowers the corporate treasurer to manage liquidity more efficiently. It liberates them from the tyranny of bank float days. No longer, do salary files have to be sent by 2pm, for them to be processed. Salary files can be sent to the bank at 10:00 pm, and the salary credited at 10:01 pm, on the same day.

Eases the cost burden

Most banks today, have stringent cut-off limits. The narrower the window to the cut-off time, the more charges the corporate has to bear. With the Instant payments framework in place, the float days are minimized, and the charges expense model is diluted. While the jury is still out on the new pricing mechanism for the reduced float, the envisaged benefits of reduced fees and charges are undeniable

The predictability and immediacy of the payment transaction reduces credit risks in the supply chain and could accelerate the flow of goods and services in the economy. It can also help free up working capital by opening up the possibility of just-in-time stock management.

The certainty of the payment, in terms of payee and recipient notification, together with the usage of ISO 20022 standards can simplify payment reconciliation

Improved invoicing, and real-time payments, when connected to tracing and tracking mechanisms of goods, can enable auto generation of invoices at supply chain gateways, freeing up working capital for both sides.

Promote Just-in-time business models

Small and Medium Enterprises that operate on close-controlled cash flows, faster clearing with real-time notification of payment could offer a way to avoid late payment charges and adopt just-in-time business models. Supply chain retailers might be able to reduce their inventory levels, since immediate payment receipt would enable immediate shipment and order fulfilment

Potential for International Trade

SWIFT announced that a new European instant payments solution ^[3] will be available in November 2018. This solution is the latest development in SWIFT's global strategy for real-time payments, and builds on SWIFT's earlier success in Australia

International trade transactions can be accelerated, eliminating credit issues and avoiding expensive delays, if instant payments are extended across the borders

THE WRITING IS ON THE WALL

For corporate banks there is not much room for flexibility. They have to adapt and meet the rising expectation of their corporate customers. Real-time payment is a given.

But, what does it mean for the existing systems and processes?

- Core processing should be available on a continuous basis and deliver 99.9% availability
- 24x7 operational availability also means, the current end-of-day processing business architecture must be redesigned

The inevitability of this realization, paves the way for the possible responses, which the corporate bank must persevere, each one fraught with its own advantages and challenges:

1. Upgrade existing systems

- High Impact on internal Infrastructure
- Poor Documentation availability
- Resource limitations
- Old legacy systems

2. Implement a modern best in class payments hub, with Instant Payments

- Minimize impact on internal Infrastructure
- Redesigning operational processes
- Possibility of progressive implementation, becomes a fulcrum for transformation strategy
- Long term strategic initiative

3. Get applications specifically designed for instant payments

- Leave the existing internal Infrastructure, as-is
- Low impact and fast- time-to-market
- Risk of traditional payment processing still stuck in legacy technology
- A near term perspective
- Introduction of payment silos

THE TASK AT HAND

It is imperative that the solution framework be able to scale up to the stringent standards of immediate payments, while not sacrificing regulatory compliance.

Whether banks adopt a big-bang approach to refurbish the internal IT infrastructure, or choose to undertake a progressive transformation of the technological capability with the ability to disseminate the ISO 20022 standards across the value chain, or at the very far end, the independent capability of an instant payment application, the common denominator defining the solution, in each of these cases can be summarized as,

The solution must be able to conform to the standards of the legacy system. Restrict the changes to the old system to a minimum, while addressing the architectural mandates,

- The ability to design workflows to orchestrate the payments business logic. A business driven development which banks can adopt. Business, IT and operations can collaborate together and break down silos.
- Open API enable extensibility hooks to latch on to the external frameworks, which gives it the ability to customize for each individual bank requirements
- Support for ISO 20022 standard framework
- SOA based architecture to allow for progressive evolution of framework
- The framework for Instant Payments

CONCLUSION

The advantages Instant payments presents to the business and corporates are a moot point. At this stage of the financial market churn in technology and regulations, corporate benefits are still confined to domestic operations of liquidity management and working capital visibility.

And banks can no longer avoid balancing prudence with agility. Technology standards like ISO 20022 have injected the much needed interoperability but they also present a competitive threat. Corporates can now easily switch their banks.

The potential of instant payments in corporate business is real. And corporate banks must make the transition to an SOA based payments framework, architected using open APIs, exchanging standardized ISO 20022 messages with the ability to orchestrate rule based payments business logic to be able to continue to serve its business customers.

And the switch need not be a “zero-sum” approach, but a gradual progressive transformation, exploiting the modular componentized business design and logic of the intended end point solution.

The journey of 1000 miles begins with the first step....in the right direction.

SOURCES

[1] EPC173-16 SCT Inst Rulebook - 2016 Public Consultation comments & EPC responses.pdf

[2] CPMI – Fast payments – November 2016 (Committee on Payments and Market Infrastructures)

[3] <https://www.fx-mm.com/news/69415/swift-announces-european-instant-payments/>

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