Future trends in payments

A synopsis of the industry's response to Pay.UK's first 'industry challenge'

Contents

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Introduction

In February 2021 we published a white paper titled 'Strategic trends: Retail payments in a future world'.

One of our key objectives is to ensure the continued relevance, competitiveness and usefulness of the services we provide as part of the UK payments ecosystem and engaging with our stakeholders is vital to that. We therefore launched our first industry challenge – based on the white paper – asking the payments community to consider how the future of the industry had been changed by the Covid-19 pandemic.

We received responses from different organisations based not only in the UK, but from markets as diverse as Pakistan and Canada, with an intriguing and thought-provoking set of ideas regarding what the payments world of the future might look like.

In our view, Covid-19 has undeniably altered the landscape ahead of us , and the industry is excited, open and ready for fresh innovation to meet the challenges, and realise the opportunities created by a changing world. The feedback we have received is largely aligned with the trends we identified within our white paper and encourages us to maintain our open dialogue to address these trends that could impact all of us in the longer term.

Experts have put a spotlight on: digital payments; fintechs and big tech; central bank digital currencies (CBDCs); and data-led innovations. These present us with invaluable views that will help us develop our strategic position, inform the scope of our research projects and engage further with the industry. Our first challenge has proven why we should continue to stimulate debate – because not only will it benefit us, but it will also help our customers, our stakeholders, our end users and the wider ecosystem.

Below is a synopsis of the trends that experts believe have been impacted by the pandemic, and what this means for the industry in 2030. We also provide our own views below regarding what this means for the future of retail payments.

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How has Covid change the future of payments?

Covid-19 has significantly impacted our everyday lives – not only for today, but for the longer term. There were a number of key themes raised in light of this, which are explored in greater detail below.

1. The substantial drop in cash usage and associated rise in digital payment solutions

One unsurprising trend accelerated by the pandemic was the significant drop in cash usage, pointed out by all contributors, who also recognised this as the acceleration of an existing trend. Experts from across regulators, fintechs, and financial institutions suggested that the move from cash to digital payments for the reason of reducing the risk of contracting or spreading the virus is a habit that will stick – a view echoed by several others, including one who pointed to the '21/90[1]' rule in habit forming within human psychology.

The future could see the creation of a cashless society. Experts from Canada suggested that the first to transition could be developing economies with sparse financial structures in place, remote geographic areas and highly digitised economies. However, one corporate banking expert asserted that cash is not going to go away and it is still 'king' in many emerging markets. Since our challenge ended, the Bank of England announced its intentions to close its Leeds cash distribution centre as it expects demand for distribution of the new polymer banknotes to fall. This is not only due to their greater durability, but also because of the continual decline in the use of cash in the UK.

We agree that whilst cash usage has declined steeply, it still plays an important role for many in society and its future has resounding implications from a financial inclusion perspective. We agree with the opinion of a payments advisory expert that digital payment solutions should be accessible, inclusive and equitable for all in society. As a retail payment systems operator (PSO), we have a responsibility to consider the effects of the drop in cash usage, and we are in support of the various initiatives rolled out by the ecosystem to increase financial inclusion and digital education. These include Barclays' Digital Eagles programme for the elderly and Visa's efforts to allow people to continue to access cash using its network.

2. Technology companies in payments

With the use of digital payments accelerating during the pandemic, technology companies have ventured further into this area, and contributors to the challenge see this movement continuing into 2030. Canadian experts pointed to the rising trend of internalisation, where large technology

[1] The '21/90' rule asserts that it takes 21 days to form a habit, and 90 days to become a permanent lifestyle change.

platforms such as Amazon and Alibaba cut out traditional payment schemes to provide an 'on-us[2]' payment capability between their platforms and the merchants in their marketplaces. Our white paper discusses internalisation in greater depth here. An interesting example is Facebook-owned WhatsApp, which provides WhatsApp Pay in both India and Brazil, allowing its users to send money directly through the app. Such developments reinforce the view that people will turn to technology platforms for their everyday financial needs in the future.

In parallel with these developments, partnerships between financial institutions and fintechs continue to grow. This is a business model that we expect will continue well into the future, despite the different cultural backgrounds and regulatory environments of the different parties. One of the experts identified the partnership model as likely to result in greater efficiency and added value across the customer value chain.

A key development within the last 12 months that has the potential to reshape the future of payments is the introduction of a new omnibus account model within the Bank of England's Real-Time Gross Settlements (RTGS) system. The proposed model allows the RTGS system to interface with a wider range of innovative payment systems – significantly, including those based on distributed ledger technology. Digital currencies may become more commonplace if fintechs are able to plug into central bank infrastructure. Fnality, a firm that proposes the use of bank settlement on blockchains using tokenised money based on a common account at the central bank, has welcomed the move and has already applied to hold an omnibus account. For us, the renewal of the RTGS system promises several benefits, including interoperability with the forthcoming New Payments Architecture.

3. Steady movement towards digital currency, including central bank digital currency (CBDC)

Digital currency has remained a hot topic over the last year, and was identified by nearly every contributor as a key component of the future payments industry. Canadian experts mentioned that the cryptocurrency market hit a capitalisation of over a trillion dollars earlier this year, suggesting that the industry is here to stay. A digital and corporate banking expert from Pakistan envisages digital currency in the mainstream public arena in 2030, whilst other experts emphasised the benefits of increased choice for customers who expect cheaper and faster payments in a digital world. Facebook's high profile proposed stablecoin Diem, for example, has the potential to disrupt the industry due to its reach and network effects. As of the last quarter of 2020, Facebook had 2.8 billion monthly active users.

We recognise the various benefits of increased payment choice, but would emphasise the importance of reducing exposure to risk as digital 'currencies' are not currently subject to the same degree of regulatory scrutiny as other payment types.

[2] 'On-us' payment capability refers to the integration of payment systems with marketplaces.

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One banking expert pointed to the increasing importance of CBDCs in particular, referencing the Bank of International Settlement's study earlier this year which predicted that a fifth of the world's population will have access to a CBDC in the next three years. Interest in CBDCs has grown significantly over the last year as central banks see it as an opportunity to promote financial inclusion and drive greater efficiencies in the payments industry within the safe confines of central bank backing. We do not need to look far to see central banks experiment with the currency. Sweden, the world's oldest central bank, has concluded its first phase of testing for e-Krona and is now bringing in banks to test how it may work in practice.

A payments advisory expert suggested that key players in this field, which include regulators, industry and PSOs such as us, should drive the debate on the future role of a UK CBDC. Since the challenge ended, the Chancellor, Rishi Sunak, announced a taskforce led by the Treasury and the Bank of England to explore the possibility of a UK CBDC. We agree that the pace of progress on CBDCs around the world calls for an in-depth investigation by regulators and key industry organisations, and we will be looking to engage with this to represent our customers and the wider retail payments industry.

4. Data-led innovations in biometrics, cloud computing and artificial intelligence (AI)

There was a general consensus that data-led innovation is crucial to the future of the payments industry, as it places the customer at the heart of payments innovation. One banking expert pointed to the value of customer insight, through which the industry is better able to understand customer detriments and create a customer value proposition – a "design thinking" mindset. One payments messaging expert sees this as purpose-led, responsible innovation. This view resonates strongly with us, as we focus on customer and end-user benefits. That expert further suggested that by coupling data insights with ISO 20022, the global standard for payments messaging, and by implementing additional instant payment schemes, the global payments ecosystem will facilitate automation and global interoperability.

AI and cloud computing prompt significant expectation amongst the industry for future product and service developments. The reason this is exciting for many is because it breaks down operational silos and provides access to data in one place, resulting in greater operational efficiencies and a smoother and happier customer experience.

Increased use of biometrics could also offer significant benefits in fraud prevention and cyber security, helping to drive efficiencies in these areas. It could also be used in the creation of Digital ID, which could be used around the world. Experts from Canada referred to the rise in applications for government aid as a result of the pandemic as millions lost their jobs or were furloughed. In the UK, the Department for Digital, Culture, Media and Sport created the Digital Identity Strategy Board to enable the use of digital identity across the UK. This comes after data revealed that 2.6 million people applied for the Self-Employment Income Support Scheme (SEISS) which was introduced last May. Canadian experts suggest that a universal identity system capitalising on domestic digital identity networks is not far off from becoming a reality.

We agree that biometrics can provide many benefits, particularly in the payments space. Like many in the industry, we are participating in the conversation to shape the payments use case for Digital ID in the UK via the Payments ID Industry Working Group.

What's next?

The rich conversation our challenge initiated has provided indispensable input for us to consider in relation to our strategic views as the UK's retail payment systems operator. It provides insight into the areas of the payments industry and beyond that we should monitor and investigate further, as well as prompting us to consider the scope of our various research projects. In particular, it helps us develop an informed strategic position and supplements our ongoing engagement with the industry. We will continue to consult with stakeholders on realising threats and seizing opportunities that put the UK at the forefront of a changing world.

We are committed to our role as a payment systems operator and systemic risk manager. We have created and launched a Knowledge Hub, which is continually updated with our own thought leadership as well as articles from the industry to inform our views on what trends are emerging and how these are viewed by industry subject matter experts.

We will also continue to engage widely with the stakeholder community to identify and respond to emerging risks and opportunities, as well as continue to build on the capabilities of our Knowledge Hub as the home of a collaborative community of payments innovators. In this way we can create a shared view of the trends set to shape the payments market.

We hope that you have found our first industry challenge informative and we look forward to continuing our dialogue with you.

Join the conversation on our Knowledge Hub

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