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The Future of Real-Time Payments Post-ISO 20022: Considerations for Banks

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The financial services industry has evolved significantly over the past several years. Yet, when it comes to payments, most economies are still using systems and technology developed in the 1970s and '80s.

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Think about how we all pay for things. In general, we have two primary options — cash, which is currently the only available real-time payment method available to everyone, and credit/debit cards and automated clearing house (ACH), through which payments can take up to several days to process. As our society continues to advance digitalization across almost every facet of our lives, cash is quickly becoming an outmoded currency. And the immediate (or near-immediate) gratification we experience in many other areas (e.g., retail, delivery, communications) has caused a distinct shift in consumer preferences. We want everything to be as quick and reliable as an Amazon delivery. Thus, clunky, convoluted credit/debit card and ACH transactions long ago outlived their practicality.

Further, the U.S. economy is hindered by the delay in the payment network. The "unbanked" and "underbanked" (19% of the population), largely lower-income and minority households, are most affected by being cash to hand and unable to fully embrace the digital economy. They also disproportionately struggle with the ramifications of delayed settlements. In the interim between when someone slides their debit card through the processor at a retail store and the moment it posts, a lot can change in these individuals' accounts, making repeated overdraft fees a real concern.

Merchants, too, are becoming increasingly frustrated by these delays. In essence, this group and the unbanked/underbanked population are both struggling with a similar conundrum revolving around interrupted cash flow and reduced access to their money (not to mention the underlying fees and hidden charges to use these services).

This illustrates why, in recent years, there have been increasing calls for a faster, more reliable, and more transparent system for processing financial transactions. Real-time or near-real-time payments promise better cash management for consumers, improved liquidity for businesses, and enhanced security for institutions. And there are various pressures building up to bring about this change in the industry — security being one of the foremost.

In 2016, the Lazarus Group, a network of North Korean hackers, stole $81 million from the Bangladesh Bank. This acted as a wake-up call that many global banking systems are not as secure as once believed. But this was not an isolated incident, and the ongoing activity of this group should be cause for alarm among governments and financial institutions far and wide.

The U.S. House Committee on Financial Services meets regularly to discuss the implications of security and equity in these systems, yet little progress has been made to date. In 2023, the U.S. is expected to release FedNow, an instant payment service developed by the Federal Reserve Banks to empower safe and efficient payments. It's the first time the U.S. government has given prescriptive guidance on this topic, and it addresses the gamut of security and compliance issues that come along with payment reform.

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At the same time, there is also a real risk for incumbent banks from innovative new fintech providers entering and disrupting the market to deliver this unmet need. There are several new technologies that offer high-speed, low-latency avenues for facilitating financial transactions in the blink of an eye, with faster settlement implied.

Another factor influencing the trend toward real-time payments is the impending release of ISO 20022, an international financial standard for passing messages between institutions. Expected to be the universal standard for payments by 2025, it is a fundamental rethink of how payments and treasury management services can and should work. This shift will require banks to quickly expand their capabilities related to data processing and authentication in order to meet this new standard.

5 Real-Time Payment Considerations for Banks

In light of these trends, the question for banking leaders becomes what do they need to do right now to begin putting this into practice at scale?

Although the banking industry is notoriously slow to innovate, when it does happen, it happens fast. Banks that aren't making the right strategic decisions and investments will see opportunities pass them by to take advantage of this new frontier. Below, we've listed a few considerations for leadership.

1. **Education:** Beyond merely attending an ISO 20022 conference, banking leaders need to be investing in training for their teams. As with most technological advancements, the adoption of real-time or near-real-time payments (and the systems that support them) will most likely require a new set of skills. Leaders must be intentional and deliberate in setting their teams up for success.
2. **Product Development:** Innovative banks will likely already have their product development teams working to uncover how these real-time payment trends will impact their existing products and identify any gaps in their product suite. It will also be key for these teams to determine how much these pivots will cost to execute.
3. **Infrastructure upgrades:** There will be significant costs associated with modernizing the payments infrastructure within banks. All the systems that issue payment instructions are going to

have to be updated, and it will also be essential for banks to take a close look at their vendor relationships to ensure they are also deploying a sound plan for updating their standards.

4. **Technology innovation:** As the banking industry navigates the transition to real-time or near-real-time payments, there will be more than 800 message types developed with a richer vocabulary than ever before and the ability to read other formats. A large portion of the communication between information sets will be driven by application programming interface (API). If API integration is not already a major part of banks' road maps, they are missing a vital component of a successful strategy. Biometric authentication, a commonly touted solution for ensuring the security of real-time payments, is another advancement banks need to be laying the groundwork to adopt. The adoption of 5G is also complicating matters. As it gains traction, there will be more and more information shared between devices and payment mechanisms. This will open a faster, more capable pathway for financial transactions while simultaneously making it more difficult to thwart hackers, who now also have access to this advanced technology.

5. **Change management:** Any time there's a major industry or institutional shake-up, strategic change management should be involved in the strategy. In many cases, this can differentiate those institutions that thrive under new conditions from their less successful peers.

Adapting to a Post-ISO 20022 Future

The most important action for banks right now is to realize the magnitude of the change that is occurring as well as the potential opportunities and risks at play. This evolution is serious. It's happening. And it will affect all aspects of business and retail payments.

To navigate this disruption, leaders must embrace it as a long-term operational change. For some banks, especially those with reputations for innovation or high reliance on payment services, moving quickly will be paramount. For others, a wait-and-see approach may better suit their organization's risk tolerance level.

Either way, it's past time for banking leaders to begin mapping out what this evolution will look like for their institutions. It's all about preparedness.

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