Instant Payments and the Post-PSD2 Landscape

Reshaping the retail payments market

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Introduction

Catalyst

The next 18 months will see two pivotal events in the development of the European retail payments landscape, with the widespread rollout of Instant Payments (IP) through SCT Inst in November 2017 and the final deadline for PSD2's legal implementation in January 2018. Both will involve fundamental changes to banks' own internal architectures and business processes as well as their connections to consumers.

Instant or real-time payments allow account-to-account bank transfers in seconds instead of days. Several countries, including Switzerland, the UK, and Denmark, have already rolled out Instant Payment schemes, with many more to follow, including the eurozone countries. The second large change for European banks is the access to accounts (XS2A) requirement of PSD2. This specifies that banks must allow third-party providers (TPPs), which now have to be regulated and approved, access to customer accounts.

To investigate the impact of these initiatives, and on behalf of our sponsor, Icon Solutions, Ovum has explored how this will drive change in the European retail payments market. In particular, the role that new payment services and direct to account connections will play in seeing retail expenditure move from payment cards to an immediate payments infrastructure.

Ovum view

In combination, Instant Payments and PSD2 are going to have a transformative effect on the European retail landscape, changing the way consumers pay for their goods and services. Ovum's Instant Payments Forecast Model predicts that within 10 years of its widespread implementation, Instant Payments will have become one of the three main online payment tools, accounting for roughly one-third of e-commerce spending. As a result, Instant Payments will have overtaken payment cards (credit, debit, and prepaid cards, whether payment details are entered each time or the details are held on file) as a part of e-commerce expenditure around 2024. Combined with new options at the point-of-sale, that would see over €725bn in annual Instant Payment transactions for e-commerce and at the point-of-sale by the end of 2027.

While the path will vary between markets, banks will need to be prepared for the rapid change that will occur. The opportunities presented by these developments will compensate for the challenges, but only if banks are willing and able to offer the new products and services their customers and clients will demand and increasingly expect.

Executive summary

Key insights of this research include the following:

- Three-quarters of a trillion Euros in annual retail expenditure is set to switch to Instant Payments across Europe by the end of 2027.
- Single-transaction card payments (in which the customer enters their card PAN and other information for each transaction) will drop from a 40% online market share to 11% in the next 10 years.
- Instant Payments will grow particularly strongly in e-commerce, reaching €338bn of online expenditure by the end of 2027.
- Roughly 70% of that growth will come from three key markets: Germany, the UK, and the Netherlands.
- In preparation, 59% of Western European retail banks plan to increase spending on their payments infrastructure.

A wave of e-commerce is already spreading across Europe, transforming the way consumers purchase goods and services. The coming 18 months will see PSD2 and Instant Payments combine to change the way consumers not only shop, but also pay.

Existing Instant Payment overlay services, such as MobilePay, have shown how popular they can prove with consumers and merchants alike over relatively short timeframes. As a result, Instant Payments are expected to have become a mainstream payment method across Europe by the early 2020s, and will go on to build strong positions in many markets.

In-store, Instant Payments are unlikely to offer a faster or more convenient option than existing options in the short term, but will soon make inroads for larger purchases, such as white goods.

Key to banks exploiting this shift and turning it into a revenue driver will be the launch of new value-added products and services. PSD2 will disrupt legacy business lines, but Instant Payments provides opportunities to replace and surpass existing streams.

It is expected that retail banks, merchant acquirers, and infrastructure providers will look to develop new overlay services, while PSD2 will also open up opportunities for other third-party solutions to come to market.

In combination, PSD2 and Instant Payments will prompt a major modernization of Europe's payments landscape. Even the modest initial developments will involve billions of Euros shifting onto new payment rails. The benefits are clear for merchants, and consumers look set to adopt Instant Payments, so banks should prepare to exploit rather than fight the transition.

Instant Payments and PSD2 are reshaping the European payments landscape

The growth of Instant Payments is creating opportunities across Europe for new products and services

Instant Payments (IP) is one of the most important initiatives in the retail banking industry today, and particularly so in Europe. With domestic infrastructure already in place in many markets, and with SCT Inst due to enable Instant Payments across Europe from late 2017, attention is turning to how banks can leverage the technology investments they have made – or plan to make – in Instant Payments to deliver a step-change in the customer experience and increase revenue streams.

In almost all cases, however, the move to Instant Payments at domestic or European level has been driven by regulators. The aims common to each initiative are to create the infrastructure to deliver increased speed and efficiency of domestic payments, while creating the platform for improved customer service. Consequently, innovative new customer propositions built on IP have largely been a secondary consideration in the design of schemes and in the way banks have approached the rollout to customers. Indeed, with only a few exceptions, the use of IP on the retail side of the business remains largely limited to person-to-person (P2P) payments or to replace checks and speed up transactions such as bill payments that would otherwise move across other Automated Clearing House (ACH) payment rails.

However, as IP becomes more widely available, attention is beginning to turn to the role that this infrastructure can play in reshaping the economics and user experience in the retail payments space.

Defining Instant Payments

While there remain differences across today's live IP schemes, all share the same fundamental characteristics:

- 24/7/365 availability
- Payments are non-revocable
- Interbank transfers clear in real or near real time
- The payer receives confirmation in the same timeframe

Instant Payments infrastructure is widespread in Europe, with SCT Inst a game changer

Instant Payments as a concept is not new, and has been around in parts of Europe for many years. Switzerland first launched a form of real-time settlement in 1987, and the UK's Faster Payments scheme went live in 2008. More recently, the pace of development has accelerated, and many markets are putting in place roadmaps to go live with new domestic infrastructure over the coming two to three years. Hungary is one of the latest markets to launch a roadmap to Instant Payments, which was announced by the National Bank of Hungary in December 2016.

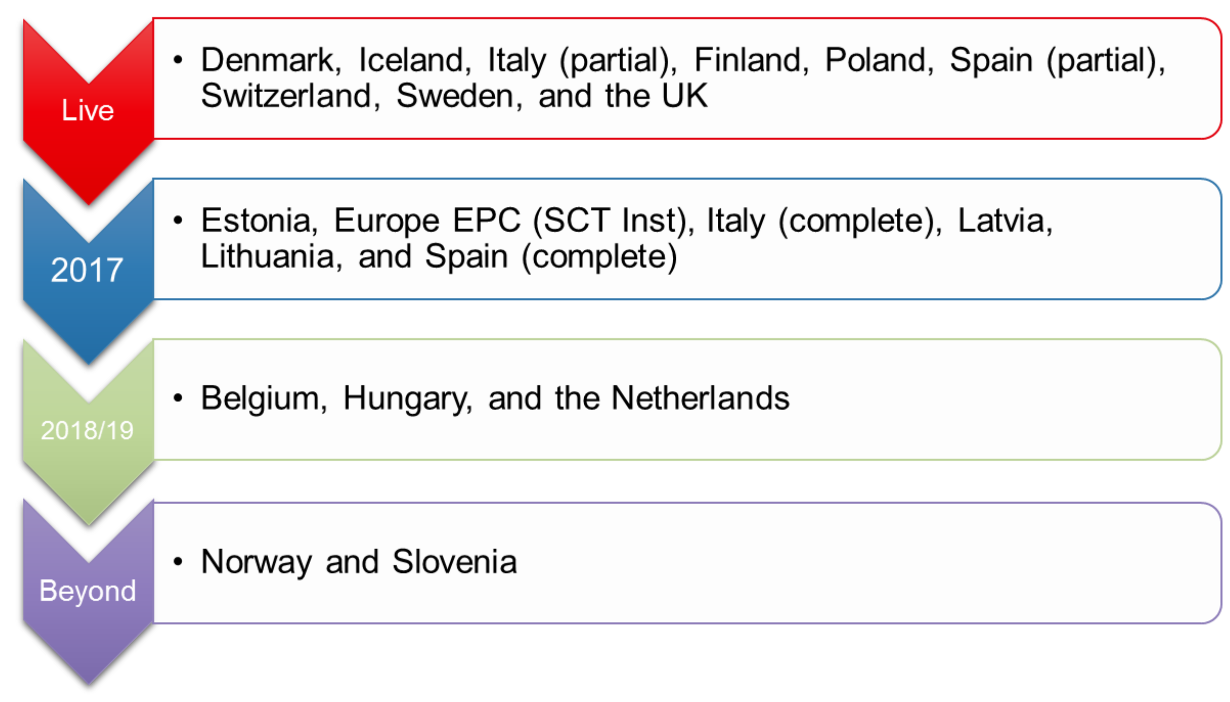
The launch of SCT Inst on November 21, 2017 will prove pivotal, opening up pan-regional Instant Payments in Euros across (eventually) 34 European countries, and will provide a mechanism for domestic payments for markets without existing domestic infrastructure. Transactions of up to €15,000 will move between participating banks within 10 seconds, with the expectation that the value limit will increase over time as part of the annual SEPA change management cycle. Many markets also have separate national schemes in development, although some will just participate in SCT Inst.

SCT Inst

Pan-regional IP scheme:

- For Euro denominated transactions, both domestic and cross-border
- Will cover 34 countries
- €15,000 limit
- Transactions completed within 10 seconds

Figure 1: Instant Payments launch dates across Europe



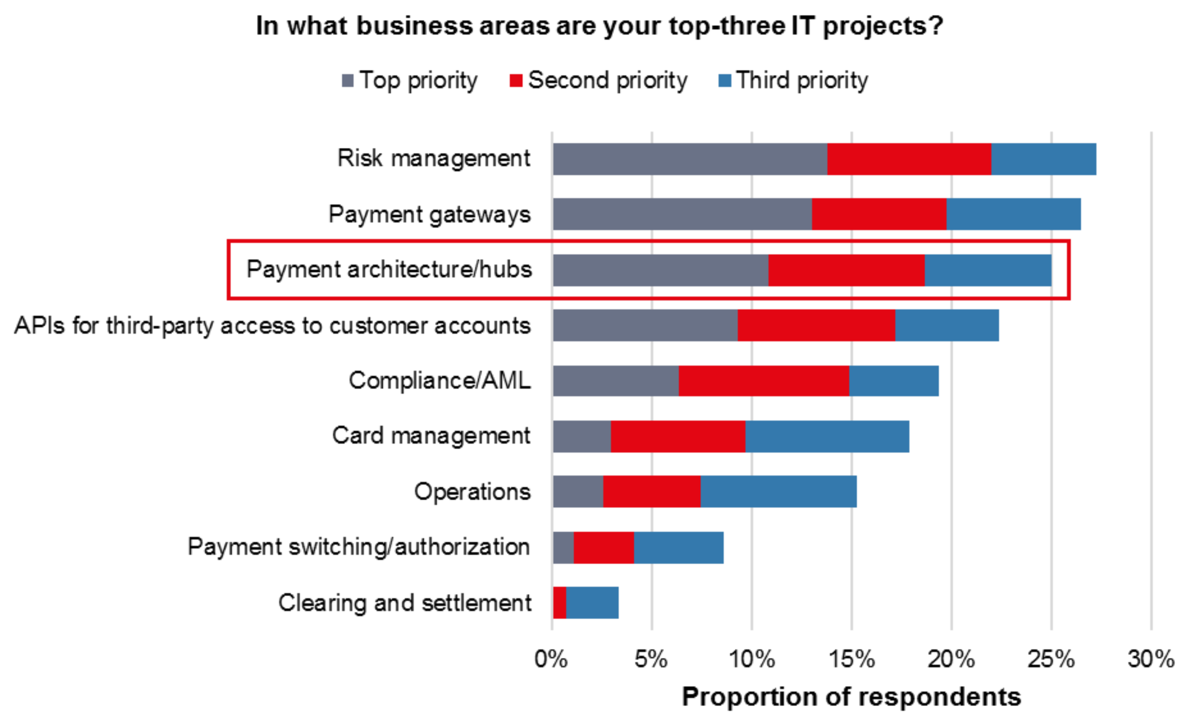
Source: Ovum

The need to deliver Instant Payments is driving banks to invest in their payments infrastructure

Much like SEPA before it, the development of Instant Payments across Europe is acting as a catalyst for investment in retail bank payment infrastructure. Faced with the need to add new connections and capabilities to their existing platform in order to support Instant Payments, many banks are taking the opportunity to make more substantial upgrades to deliver new functionality and increased operational efficiency, and to better manage legacy.

In Western Europe, 59% of retail banks are increasing their IT spend on projects to enhance their core payment architecture/hub in 2017 (according to Ovum's most recent ICT Enterprise Insights survey), with just under a fifth increasing their investment by 6% or more on the prior year. As such, it is one of the biggest areas of spending growth. Indeed, as shown in Figure 2, this area of investment is a top-three IT priority for 25% of all retail banks and the single biggest area of focus for 11%.

Figure 2: 25% of retail banks see enhancing their core payment architecture as a top-three IT spending priority for 2017/18



Source: Ovum ICT Enterprise Insights 2017/18

PSD2 will trigger a new wave of innovation and change in the way consumers and merchants transact

The launch of pan-European Instant Payments will not be the only major event to transform the market within the next 12 months. January 2018 marks the point at which the second European Payment Services Directive (PSD2) comes into force across the EU-28, which will both update the existing directive and, more importantly, increase competition in Europe's banking market through opening account access to a wider range of payment service providers.

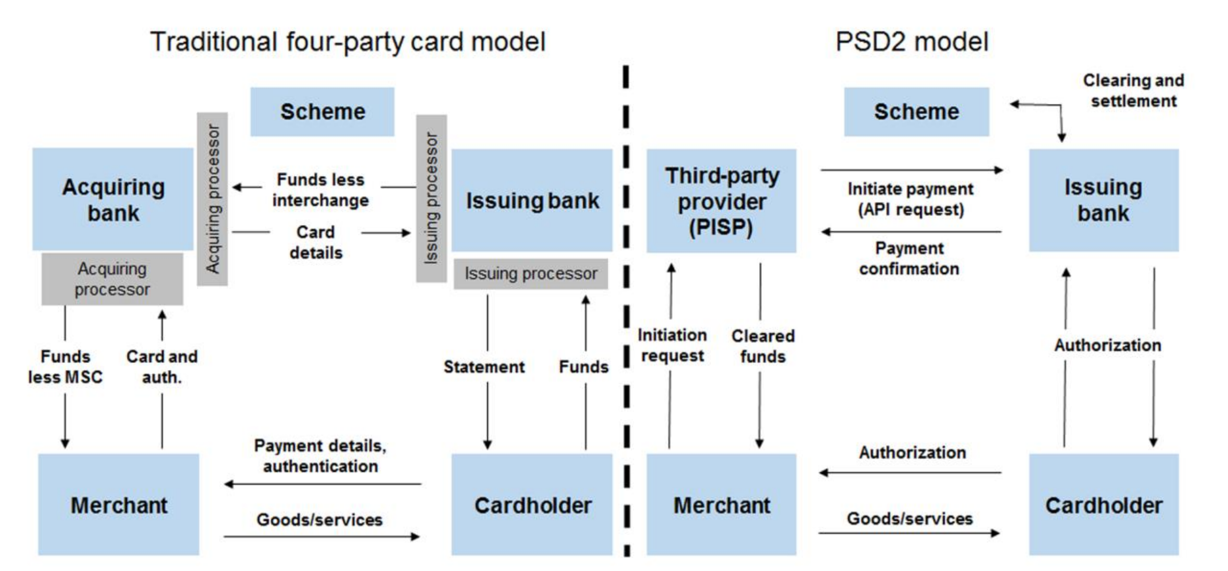
The most disruptive element of the directive will be the changes brought about by the access to accounts provisions (XS2A). Under this, customers will be able to consent to two new classifications of trusted third party having the ability to interact directly with their accounts:

- Account Information Service Provider (AISP) – to which a bank will need to provide requested transaction data
- Payment Initiation Service Provider (PISP) – which a bank will enable to trigger a payment on behalf of the customer

In short, banks will need to provide APIs and associated developer support for trusted third parties to deliver services that leverage these new capabilities. The European Banking Authority is in the process of confirming the technical standards for both this and the authentication requirements to ensure that fraud risk is kept to acceptable levels.

For the banks, merchants, and the payment industry more widely, the PISP model will have a significant impact on the way in which consumers and merchants transact in the future. Unlike the traditional four-party card model, customers would "push" cleared funds to merchants, with ACH transactions replacing the current card rails in this scenario. This will significantly simplify the existing payment model, with fewer players and interactions involved.

Figure 3: Comparison between the existing four-party card transaction model and that created by PSD2



Source: Ovum

Instant Payments will become a major part of the retail payments market

PSD2 will drive the use of Instant Payments in digital commerce

While the impact of IP and PSD2 will drive change independently, the pace will accelerate in those markets that are impacted by both simultaneously. By itself, an Instant Payment provides clear defined benefits over established options, but PSD2 will help to unlock its full potential. Similarly, PSD2 will have a significant disruptive effect on the European payments landscape, regardless of whether Instant Payments are ready.

Strong benefits on offer from Instant Payments for merchants

Merchants would face strong cost incentives to move to accepting Instant Payments over payment cards and digital wallets (such as PayPal), particularly in e-commerce. Firstly, receiving cleared funds would mean they would be able to reduce chargeback costs where volume moves away from card-not-present (CNP) transactions. The faster receipt of payment will also have cash management benefits, potentially improving liquidity and reducing reliance upon revolving credit facilities in some cases, resulting in further cost savings. Similarly, transaction costs for any merchant who chose to become a PISP or accept Instant Payments via an intermediary would be highly likely to be lower than the current costs of card acceptance.

However, it should be noted that there are other benefits brought by both digital wallet platforms and payment cards that add value to merchants through driving additional incremental sales. This is core to the value proposition of the larger wallet platforms in particular, while loyalty incentives, broader engagement tools, and the repayment terms available on credit cards also drive additional consumer activity and spend volumes. For a merchant, it is clear that a move toward incentivizing Instant Payments as a payment option for customers would need to occur in parallel with other initiatives to deepen customer engagement. Indeed, the potential cost reduction from migrating a share of payment card volumes to Instant Payments may offset much of the investment in customer engagement programs for some merchants.

Instant Payments offer benefits for digital wallet providers

Digital wallet providers should also be expected to take advantage of the opportunity to become PISPs and move away from using the payment card rails as a funding source for wallet transactions. As with merchants, a reduction in per-transaction payment costs and chargebacks would be the principal benefits, although "fast settle" premium services may be offered to help with cash management. This may, in turn, allow them to compete more aggressively on cost grounds to acquire new merchants.

New products and services will drive consumer adoption of Instant Payments

For consumers, particularly when online, it is likely that the adoption of IP as a straight replacement for existing methods will be a slow process. This is likely to begin with those retailers they regularly transact with as and when current payment information (particularly card-on-file details) requires updating, either through card details expiring or after prompts from the retailer. Convenience will be key to that process, with many consumers likely to choose Instant Payments as an easy choice to replace expiring payment tool details where the onboarding process is sufficiently frictionless (and/or is sufficiently well incentivized). Given the availability of solutions to enable easy capture of the card PAN and other information using the camera on a smartphone, this is an area that would require investment. The cost savings for merchants, however, would enable them to offer incentives to switch, which are likely to have a more significant impact at driving short-term proactive changes.

Most consumers do not care how they make a transaction, as the payment is the final step to overcome to complete the purchase of a desired good or service. Convenience and speed to complete the payment are the chief considerations, with incentives likely to become an increasingly important part of the mix when it comes to IP. As a result, the use of credit cards – particularly where merchants are using tokenized credentials – and digital wallets will remain important fixtures of the retail payment landscape for some time to come, despite what is likely to be growth in the use of IP.

Card schemes are already preparing for the change in payment model

Any migration away from either the direct or indirect use of payment cards (the latter in the case of funding third-party wallets, such as PayPal) would pose a significant challenge to the card schemes, of course. MasterCard and Visa have both invested heavily in merchant-centric solutions in recent years, notably the 3D Secure 2.0 initiative and innovation around their tokenization services. Indeed, the launch of several end-to-end offerings for specific merchant verticals (such as vending, the connected car, or taxis – as already seen with Uber) are aimed squarely at embedding the payment card model into a number of verticals. At the same time, developer-friendly API portals enabling products including tokenization, wallets, payment gateways, and fraud decisioning are aimed at maintaining their market position.

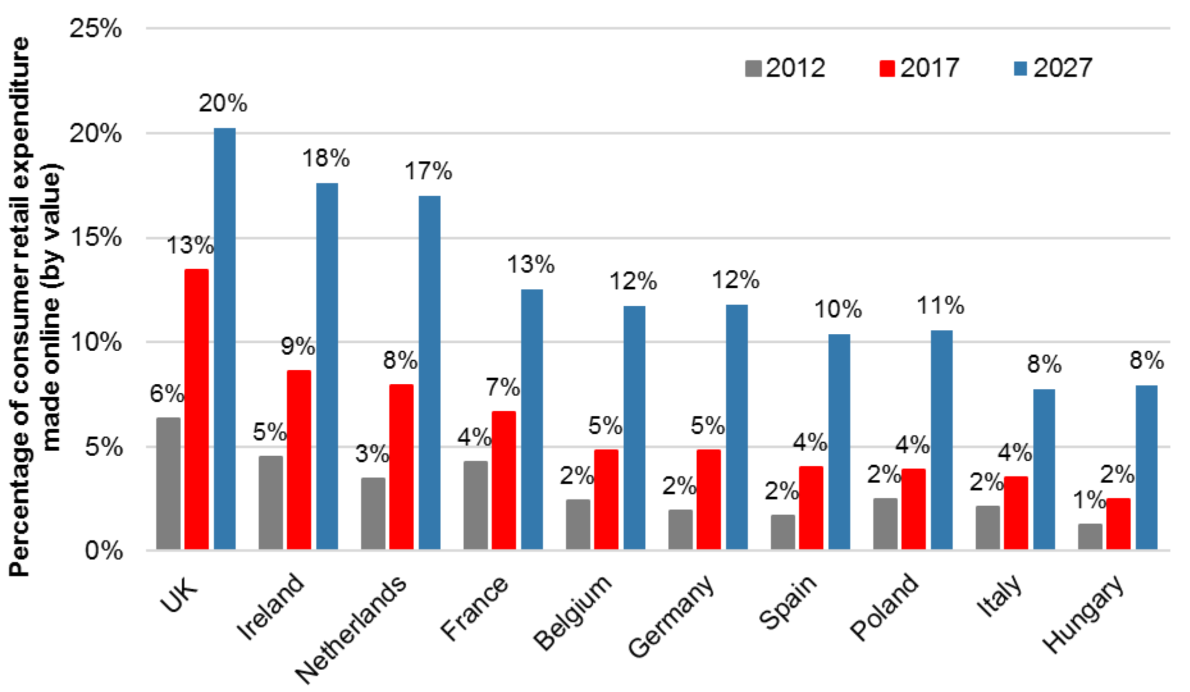
At the same time, retail banks, particularly those with large revolving credit card portfolios, would see fee and interest revenue from their payment cards business decline as a result of a migration toward IP. The strength of the market position that the schemes hold, alongside the need for banks to protect their card revenues, will ensure that payment cards continue to hold an important share of the retail payments market.

The continued growth of e-commerce will be a catalyst for this change

Behind the changing methods available for consumers to pay for goods and services is the huge growth in e-commerce, which is changing the very nature of retail both in Europe and worldwide. Up until quite recently, e-commerce was relatively niche in most markets, covering segments such as travel and e-goods. What has been seen in the past few years, however, is a sustained expansion to include the full range of goods and services, and across the entire region. This has come from a mixture of changing consumer preferences, new consumer technology such as more digital goods, and retailers looking to exploit the cost savings versus traditional channels. Consumers also tend to appreciate the greater choice, more information, and a feeling of control when purchasing online, much of which contrasts with existing in-store sales approaches.

While the UK continues to lead the region, with almost 13% of all retail spending now made online, the highest growth rates have recently come from other major markets. Ireland and the Netherlands are expected to close the gap on the UK over the next decade, with each approaching 20% of total retail expenditure being made online by 2027. Conversely, France is likely to lose ground compared to similar markets due to weaker e-commerce infrastructure and retailer reluctance to change business models. Indeed, France's growth rates over the past five years have consistently been much lower than the regional average, but it does have the greatest scope for performance to improve in the medium term. At the opposite end of the scale, e-commerce is currently a niche segment in Hungary, but it is expected to burst into the mainstream over the coming years, recording growth exceeding 20% per annum in three of the past five years and with more retailers now developing their online capabilities.

Figure 4: European e-commerce market is expected to grow at an average of 10% per year



Source: Ovum

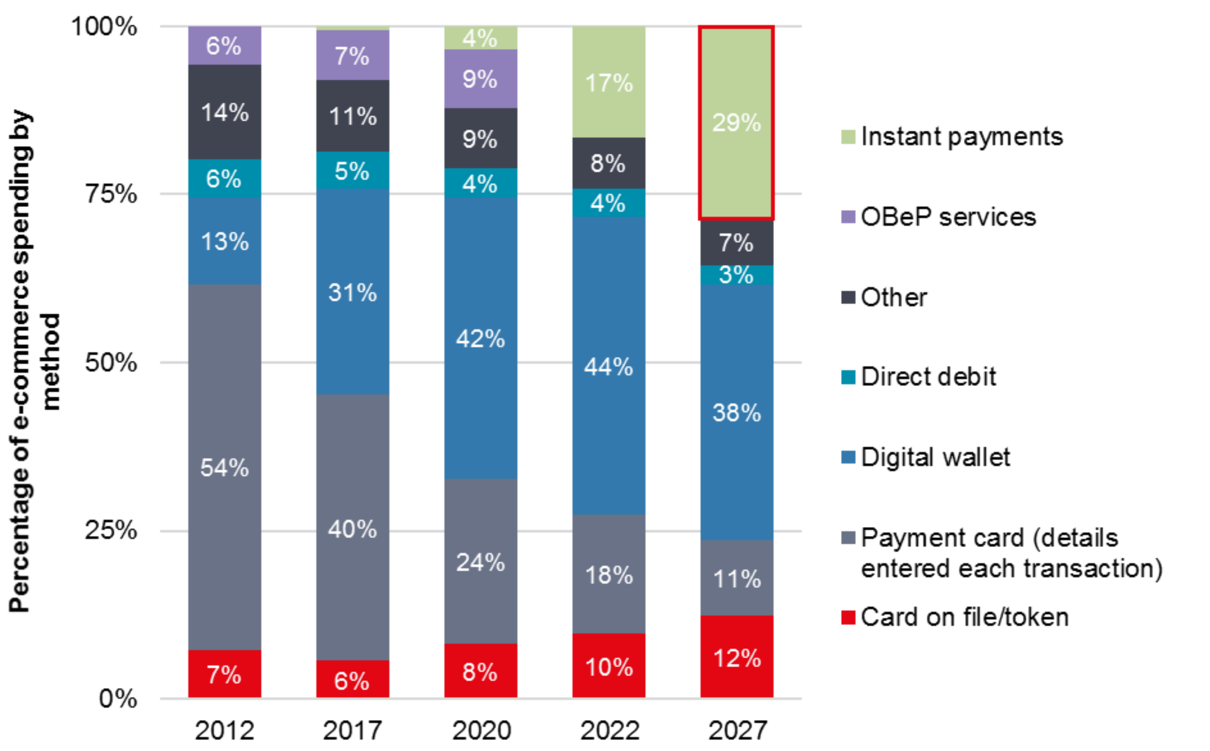
The shift of European commerce to digital channels has prompted merchants to increasingly take an omnichannel approach and focus on enabling the acceptance of new payment methods, as a key part of their investment strategies. Two-thirds of merchants reported in Ovum's 2016/17 ICT Enterprise Insights survey that they are increasing their investment in digital sales channels, for example, with almost as many saying they were making similar increases for new payment methods. This will help fuel the existing shifts in consumer behavior, setting the scene for a transformative environment where Instant Payments and PSD2 will further disrupt established retail habits.

PSD2 could enable IPs to account for a third of e-commerce expenditure across Europe by 2027

Based upon the opportunities provided by PSD2, Europe is poised to see significant changes in the way consumers pay for goods and services. The largest of these shifts will be in Instant Payments, which Ovum forecasts will reach €338bn, or 29%, of direct, consumer to business online expenditure by the end of 2027 (10 years after the effective implementation date of PSD2). The effective total value of Instant Payments within the overall e-commerce payments chain use will likely prove higher still than the headline figure, through Instant Payments being used to fund some digital wallets.

Instant Payments will effectively absorb much of the rapid growth expected in European e-commerce over the next decade, which will gradually see a market share increase against established payment methods. This is expected to range from 72% in the Netherlands to just under 20% in Italy, where cash-upon-delivery remains stubbornly popular among some demographics. Ovum expects single-transaction card payments (the manual entry of card details for each payment) to be the hardest hit by Instant Payments, declining from a 40% market share to 11% in 2027. Some of that drop will be from payments switching to card-on-file/tokenized credentials, however, with payment cards remaining a major part of the online retail landscape. The transition to card-on-file is one that is expected to accelerate from its existing rate, as payment schemes and retailers look to push consumers toward more convenient, more secure, and faster tokenized transactions. While dropping in market share, payment cards (irrespective of transaction entry method) are still expected to record slow growth in real terms over the 10-year timeframe, reaching roughly €260bn in 2027.

Figure 5: IP will become a top-three method for online payments across Europe by 2022, growing to account for 29% of transaction values by 2027



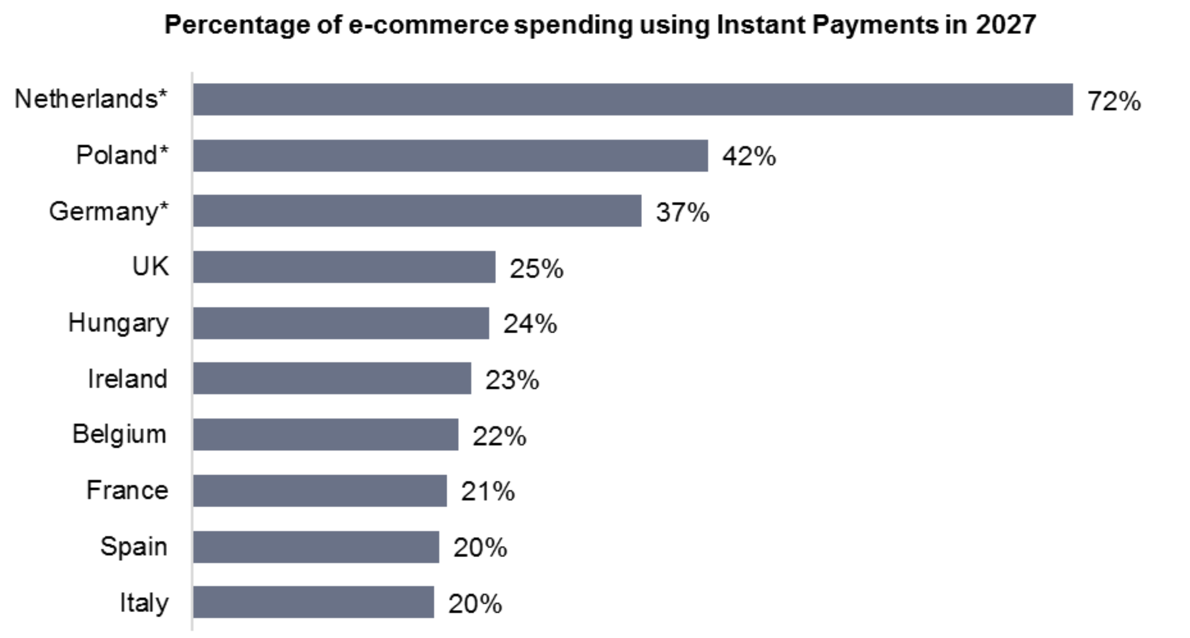
Source: Ovum

Largely due to the relative size of their online economies, Germany and the UK are expected to drive regional growth in Instant Payments, but the Netherlands will also be a strong contributor assuming the near-inevitable migration of iDeal (an Online Banking e-Payment [OBeP] scheme) volumes to the forthcoming domestic Instant Payments infrastructure. Together, those three key countries should account for roughly 70% of the total growth across the 10 European markets in this study.

Instant Payments make significant inroads into some e-commerce payment markets

Consumer convenience and comfort will be two primary factors in deciding the rate at which IP is adopted in each market. Based on the reasonable assumption that existing Online Banking e-Payment schemes, such as iDeal, will look to migrate volumes to Instant Payments infrastructure in the medium term, the biggest market impact will be in those markets where consumers are already used to this form of payment, making the Netherlands a particularly large market for Instant Payments in e-commerce in the future. Poland also looks set to be a particularly exciting market for Instant Payments after PSD2, given the combination of proven consumer willingness to adopt new payment methods, Express Elixir already being operational, and the current heavy use of single-entry debit card payments, which are ripe for displacement by simpler Instant Payment options. Rapid organic growth is also expected in the UK, where 28% of transactions currently involve single-entry debit card payments.

Figure 6: Instant Payments expected to make biggest gains in northern and eastern Europe



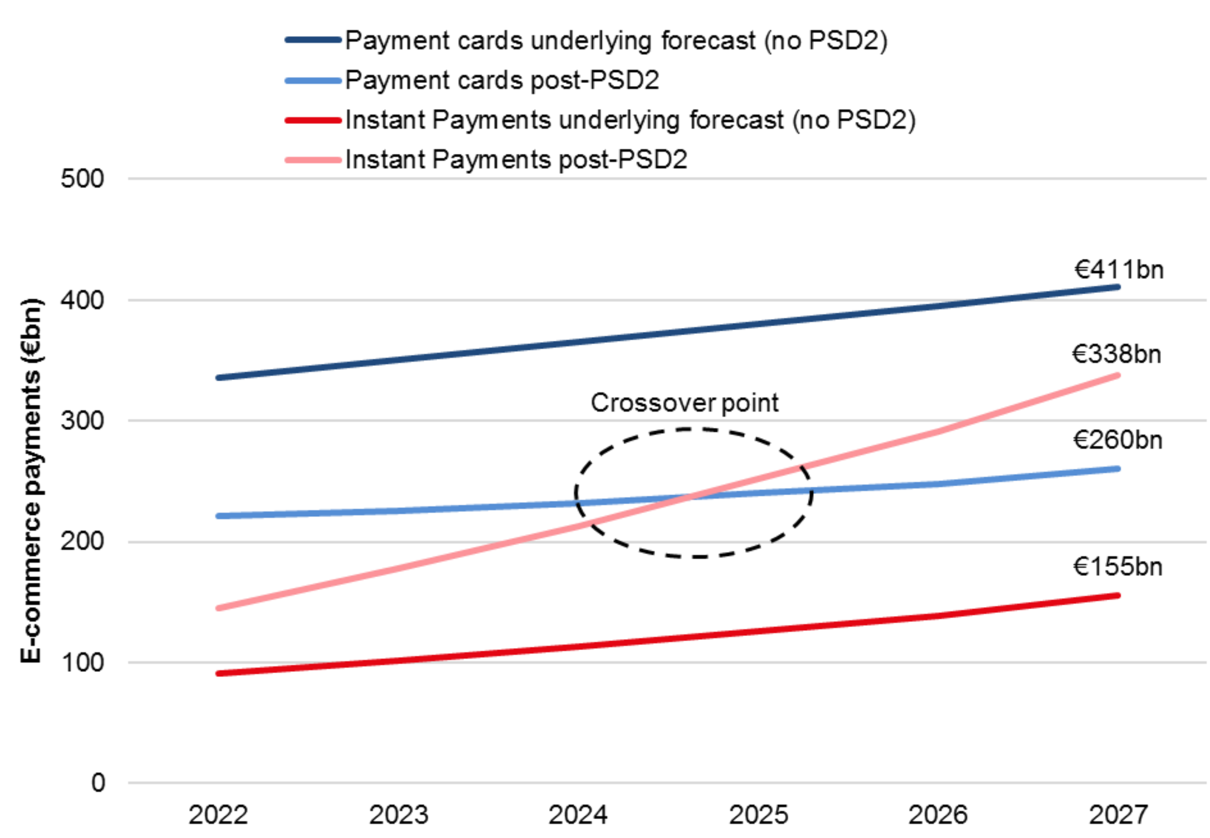
*Note: Assumes existing OBeP/ACH overlay transactions move to Instant Payments infrastructure in medium term.
Source: Ovum

The mid-2020s will see Instant Payments overtake payment cards online

The expected growth trajectory of IP across Europe, and the eating into the proportion of spending occurring using payment cards, will see it emerge as a mainstream part of the online payments landscape quite rapidly. As a result, Ovum forecasts that Instant Payments will overtake card payments for e-commerce transactions around 2024, with growth significantly accelerated because of PSD2 and its impact in opening up the payments landscape to new players, products, and services. By 2027, PSD2 is likely to lead to roughly €78bn more Instant Payments per year than payment card transactions, compared with a deficit of €255bn without.

In markets such as Germany, Poland, and the Netherlands, where existing OBeP schemes are expected to migrate to Instant Payment infrastructure, the crossover point is expected to occur a few years earlier, potentially as early as 2021 or 2022. For each market in turn, this will mark when Instant Payments become the go-to option for consumers, when merchants and banks better catering for Instant Payment will be at a commercial advantage.

Figure 7: IP expected to overtake payment cards around 2024 for e-commerce purchases



Source: Ovum

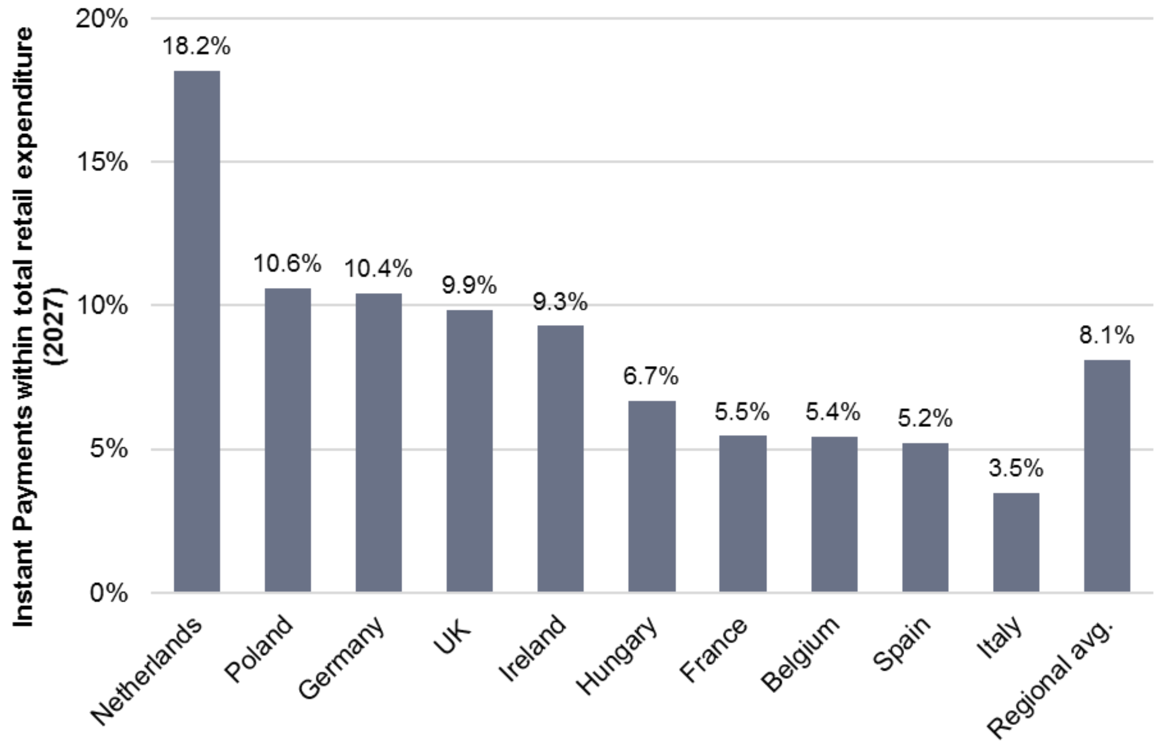
By 2027, €387bn of in-store transactions will shift to Instant Payments

Instant Payments are expected to have a more modest impact at the point-of-sale (POS) than they will online, accounting for 6% transactions by value in 2027, although that represents €387bn per year. The Netherlands, Poland, Germany, and the UK are expected to lead the shift to Instant Payments at the POS, with each seeing roughly 8% of expenditure shifting to Instant Payments within the next ten years. In contrast, the strength of cash in Italy means it is only expected to see a 2.5% move. Those faster-moving markets should provide great opportunities for banks and PSPs to test out innovative products and services, the successful of which can then be rolled out quickly and at a comparatively low cost in slower-moving countries.

The challenge for Instant Payments at the POS will be for the bulk low-value, high-volume purchases, where the rapid expansion of contactless and mobile proximity payments presents a highly competitive and challenging segment. Ultimately, Instant Payments are unlikely to offer a transaction process that is noticeably quicker or easier for consumers than what is already on the market, at least in the short term. With high-value purchases, however, where transaction completion times are not so critical, and given the potential for IP to enable merchants to reduce payment acceptance costs, merchants are likely to incentivize its usage. This is where Ovum believes Instant Payments will make the greatest inroads, for the purchase of white goods, for example, and where there are significant opportunities for banks and PISPs to provide new value-added services, similar to those currently provided through credit cards.

Ultimately, the inroads IP will make at the POS should contribute to a solid position within the overall European retail payments market, at 8.3% of total retail payments by 2027 – with a higher indirect share through the funding of digital wallets. This may sound modest, but that equates to three-quarters of a trillion Euros in annual spending, quickly placing Instant Payments as one of the main payment methods in the European retail landscape and making it a significant challenger to payment cards.

Figure 8: The largest shifts in expenditure to IP are expected in northwest and eastern Europe



Source: Ovum

These changes will create new opportunities for the industry

Banks should proactively leverage the opportunities of IP in retail payments

For banks, responding to PSD2 is not a choice, so they should be proactive and take advantage of the opportunities it provides, while trying to mitigate the consequent challenges. This should involve providing the right interfaces for developers and new services better suited to customer demands. Instant Payments offer complementary development, which can be combined with PSD2 projects to help reposition banks for the future, staying at the forefront in meeting customer expectations and keeping up with what is expected to be a rapid shift in the market. This is ultimately about ensuring that IT and the line-of-business groups collaborate fully to build the capabilities to take full advantage of the opportunities presented by both Instant Payments and PSD2. While not quite killing two birds with one stone, being ready to meet both challenges through one concerted effort will avoid duplication and ensure a single unified approach to maximize opportunities.

Clearly, one important factor for banks to consider in their investments around both IP and PSD2 is to ensure that there is sufficient scalability to manage what will be substantial growth in IP volumes, as well as the associated impact on authorization and account systems.

Where Instant Payments displace card transactions, banks will need to innovate to replace lost revenue and customer benefits

An area that banks should focus on is filling the gaps in products on the customer side, which will be particularly important in offsetting the likely slowing growth or even decline of payment card revenue streams in the medium term. For markets with a particularly large credit card base, interest on revolved balances remains an important revenue stream, but currency conversion and interchange revenue would also be challenged in credit and on debit card portfolios.

Offering new flexible credit products for purchases made using Instant Payments is one obvious opportunity where there is likely to be demand. Indeed, revolving credit lines and the option for customers to fund large purchases in structured installments are both models with a high degree of traction across Europe. As consumers switch from debit cards to Instant Payments, they will almost certainly look for a credit equivalent for some purchases, and banks catering to that demand will benefit from the ease with which customers will be able to sign up for their service under PSD2.

As has been reported in the Netherlands with iDeal, consumers often also chose credit cards instead when purchasing from small e-retailers, where trust over delivery is an issue and the consumer is concerned about the risk of non-delivery or defective goods. To address this challenge, insurance propositions or a form of "e-commerce guarantee" would be an opportunity for banks to position around their post-PSD2 account offerings.

There are already several innovative overlay services that run on top of IP in Europe

Although IP schemes have been around for many years in some markets, there remain relatively few examples of successful overlay services that banks have brought to the market. However, MobilePay in Denmark and Pingit in the UK, along with near-real-time iDeal in the Netherlands, have all proven successful in a short timeframe.

MobilePay – Denmark

Created by Danske Bank, MobilePay was launched in Denmark in 2013 for making immediate payments between users, whether retail purchases or P2P transfers, and with payments possible within other apps used by the consumer. While developed by Danske, 70% of users are reported to be customers of other banks, with roughly 3.4 million Danes (71% of the adult population) having now downloaded and used the app. It is already showing its potential, with 190 million payments completed last year, and Danish State Railways reporting that 74% of tickets bought via its app are now being paid for using MobilePay.

Swish – Sweden

A similar instant mobile payment system, Swish, has been operating in Sweden since 2012 and now has over five million users – roughly 61% of the country's adult population. The simplicity of being able to make instant and free payments, particularly P2P transfers using only a mobile phone number, has seen it become a popular option among Swedish consumers. Indeed, more Swish transactions are now being made than ATM withdrawals. With a maximum limit of SEK20,000 (roughly $2,300), and Swish enabled for e-commerce purchases in January 2017, the method is expected to increasingly compete against debit card payments.

Pingit – UK

Pingit, launched by Barclays Bank in the UK in 2012, is a good example of a P2P service that has successfully broadened into the SME space. Initially aimed at P2P transactions, funds flowed "on-us" between Barclays accounts and otherwise used the UK's IP rails (Faster Payments) to customers of other banks. Within two years of launch, Pingit had been used to transfer £540m (€620m at 2017 exchange rates). Perhaps more interesting has been the development of Pingit for businesses. For SMEs, and particularly tradespeople, the value proposition is chiefly around being able to easily receive digital payments from consumers.

iDeal – The Netherlands

iDeal is an OBeP scheme enabling online merchants to accept direct credit transfers from customer accounts. Payments are not yet instant, but close enough to provide a guide example of how successful Instant Payment overlay services may be. Launched in partnership between the major banks in the Netherlands, iDeal expanded from its launch in 2005 to a point where it accounted for 54% of e-commerce spending by volume and 63% by value within six years, a dominant position it has since maintained. When completing a transaction with an e-commerce merchant, consumers are directed to their bank's digital portal to authenticate their transaction using 2FA.

While iDeal benefited from fortuitous timing, establishing itself in the early days of e-commerce growth, it provides an example of just how successful overlay services to an Instant Payments infrastructure could be. Key to its success have been three factors: first, the near-universal reach gained from all the main banks embedding it in their banking apps; second, the low fees and speed with which merchants receive the funds encouraged their participation; and third, its ease of use for consumers soon made it their preferred online payment choice.

On the acquiring side, the ability to broaden access to Instant Payments will provide opportunities among smaller and midsized merchants

Likewise, for dealing with retail clients large and small, the combination of IP and PSD2 offers significant opportunities for banks to provide new services of mutual benefit. Merchant acquirers should certainly position Instant Payments as a payment option for their clients, whether that is in directly supporting tier-1 merchants to become PISPs or in enabling connections to customer accounts as part of the wider acquiring service.

Beyond payment services, there are wider account-related services that banks should look to provide to merchant customers. This may simply involve adjusting existing credit facilities to better suit the new cash management environment, with smaller peaks and troughs in cash balances where cleared funds arrive through the day. There is also likely to be a cascade effect, with suppliers potentially looking to switch to Instant Payments rather than on invoice – so bank credit lines and guarantees may well increase in demand on the business as well as retail side.

Merchant-specific products are also possible. For example, for a "restricted cash" product, for use when checking into a hotel, to offer an effective guarantee to cover additional costs, with a set value of the customers' cash labeled restricted to cover the payment (similar to preapproving funds on a credit card). If required, the merchant would be able to request the set-aside payment, but if not, then the restricted cash would be released back into the customer's main account. The merchant would therefore benefit from the comfort of knowing they could claim an Instant Payment to cover their costs, the customer from a real-time and transparent process, and the bank from reduced credit risk exposure.

Conclusions

The combination of PSD2 and the rollout of SCT Inst, along with national infrastructures, will catalyze a significant shift across Europe toward Instant Payments as part of the payments landscape. While up to 70% of the growth in Instant Payments is expected to come from Germany, the UK, and the Netherlands, it will still be a pan-regional development, with large shifts expected in many smaller markets. Instant Payments should make the greatest inroads online, where it is expected to account for roughly one-third of all expenditure by 2027.

Key landmarks moments include the following:

- By the early 2020s, IP will have become a mainstream method for online payments.
- Around 2024, Ovum expects IP to have overtaken payment cards for online purchases.
- By 2027, within 10 years of widespread IP rollout in Europe, they will account for roughly three-quarters of a trillion Euros in total retail expenditure.

That shift will challenge existing banking models, but it provides opportunities for banks to develop new products and services to exploit the new payment approaches, enabling them to better cater for customer and merchant expectations. Instant Payments will provide banks with the chance to make the most of PSD2, and to develop new business models to profit from the next generation of commerce.

Appendix

Methodology

Ovum's Instant Payments Forecast Model covers 10 European markets and is built around a European payments database, populated from a variety of sources including national banks, national statistics agencies, and payments associations. Combined with a minimum of three independent sets of economic forecasts, data from Ovum's ICT Enterprise Insights surveys, and a range of secondary research inputs, the model provides two outputs covering post-PSD2 and non-PSD2 scenarios of expected customer behavior online and at the POS.

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We hope that this analysis will help you make informed and imaginative business decisions. If you have further requirements, Ovum's consulting team may be able to help you. For more information about Ovum's consulting capabilities, please contact us directly at consulting@ovum.com.

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