



## **SCT Inst, CSM and TIPS – What does this mean?**

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It has been more than three years since the concept “SEPA Instant Payments” first appeared in the European payments market. In the meantime, much has been discussed:

- What does instant mean?
- What could a possible body of rules and regulations look like?
- Which mode of participation should be open to the participants?
- What use cases are there for real-time payments?

Version 0.1 of the body of rules and regulations was published in April 2016 followed by a 90-day consultation phase. Although countless conferences and professional articles deal with this theory, even today, in the fourth quarter of 2017 and just before the entry into force of version 1.0 of the SCT Inst rulebook in November this year, many market participants are still uncertain how this theory can work in the daily interbank environment. With this article, we will take a closer look at the forms of implementation and the necessary adjustments by the banks.

But let us start from the beginning. What does instant payment actually mean? In 2015, the Euro Retail Payments Board (ERPB) defined instant payments as follows:

*Instant Payments are "electronic retail payment solutions available 24/7/365 and resulting in the immediate or close-to-immediate interbank clearing of the transaction and crediting of the payee's account with confirmation to the payer (within seconds of payment initiation). This is irrespective of the underlying payment instrument used (credit transfer, direct debit or payment card) and of the underlying arrangements for clearing (whether bilateral interbank clearing or clearing via infrastructures) and settlement (e.g. with guarantees or in real time) that make this possible."*<sup>1</sup>

The European Payments Council (EPC) mentioned in its report of 06/04/2015<sup>2</sup> that the ERPB definition of Instant Payments represents a long-term vision. In order to achieve this goal, however, transitional solutions are needed and half a year later EPC published its proposal for the design of an Instant Credit Transfer Scheme. The SCT Inst Scheme, an Instant Payment based on the SEPA Transfer, was therefore born and in November 2016 the final version of the body of rules and regulations was published. The key points of the new SEPA regulations are:

- A transaction duration of maximum 10 seconds (from the moment the payer's service provider has all the information needed to execute the transaction)
- The maximum amount for a transaction lies initially at EUR 15,000
- The SCT Inst services are available 24/7/365
- The scheme is optional – financial institutions that wish to participate must be reachable, at least as the receiving bank
- The participants can establish shorter execution times and higher amount limits bilaterally or multilaterally

<sup>1</sup> Quelle: <https://www.ecb.europa.eu/paym/retpaym/instant/html/index.en.html>

<sup>2</sup> Quelle: <https://www.europeanpaymentscouncil.eu/sites/default/files/KB/files/EPC160-15%20EPC%20Report%20to%20the%20ERPB%20on%20Instant%20Payments.pdf>

Especially banks can benefit from SCT Inst as a payment method. The new scheme provides banks with an opportunity to offer their customers an account-based procedure, which is currently very attractive in eCommerce in addition to the usual brick and mortar stores. A great advantage for businesses is in particular the immediate crediting of payments with the payee. Finally, due to the immediate and irrevocable value date, goods can be instantly sent and digital goods can be issued without risk.

If we look more closely at an instant payment transaction, it becomes clear that banks can return to the centre stage of the execution of transaction. An area that was lost step by step over the last few years should now be reconquered. However, there are some pitfalls which financial institutions must take under consideration during implementation. These can be easily spotted in the simplified representation of a transaction's flow which is illustrated as follows:

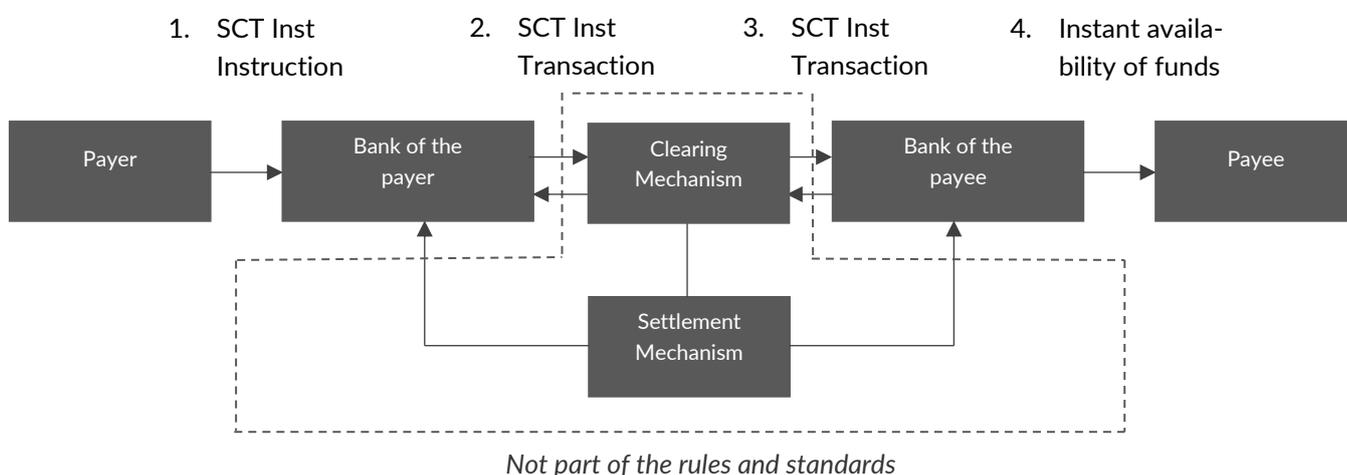


Figure 1: Flow of a SEPA Instant Payment Transaction<sup>3</sup>

The body of rules and regulations includes the entire course of the message from the payer to the payee and also the instant crediting to the payee's account.

Furthermore, it is very important which activities are not defined within rulebook. The clearing and settlement mechanisms (CSM) are completely uncovered by the body of rules and regulations and, according to the European Payment Council, they should be freely defined by the market. Simply put and without going into the depths of interbank clearing and settlement, this means that the market participants are left by themselves to deal with a difficult part - the clearing and settlement of the instant payment. Looking at today's world of banking, in the core banking system the order data is usually batch-exchanged one day after the transaction. In a nutshell, bank A and bank B exchange files once (or several times) a day, but never

<sup>3</sup> Own representation based on: [EPO04-16 SEPA Instant Credit Transfer Scheme Rulebook Version 1.0](#)



in real time and they move the customer's money from left to right. But what impact does this have on the risk management of banks?

If instant payments were to be implemented with the current infrastructure, then bank B would have to immediately provide its customer with the received money, but bank B would receive the money from bank A one day later at the earliest. Thus, bank B would take on a considerable risk. What happens if the payment from bank A to bank B does not work? Depending on the transaction volume, a delayed and guarantee-based settlement makes high demands on the bank's liquidity management. In other words, banks need solutions in order to be able to attractively offer their customers instant payments without putting themselves on the line. After all, instant payment transactions are irrevocable.

In addition, banks can establish their competitiveness against existing online payment solutions such as PayPal or sofort.de only if their solution for the customer is conveniently integrated into the merchants' online shops and if the transaction processing can be offered as cheaply as possible.

But if the crucial point of the transaction processing in real time is exactly here, then why are the CSM currently not included in the body of rules and regulations?

According to EPC, CSM represent all the processes concerning payment transactions that occur between two payment service providers and should be defined by the market needs. The separation of scheme and infrastructure allows to operate the system by more CSM. These could offer additional features and services as a distinguishing factor and for the purpose of increasing competition as long as the SEPA regulations are followed. Therefore, the EPC leaves it to the CSM organisations to build their own solutions for the SEPA schemes. The potential danger of creating multiple silo solutions lurks here, as it is often the case in payment transactions – may the multitude of mobile payment solutions be remembered.

First, let's take a look at the already existing mechanisms for SEPA payment methods:

<b>Automated Clearing House</b>	An ACH that meets the requirements of one or more SEPA schemes is based on multilateral agreements, in the context of which the members submit to common rules and standardized procedures. The transactions are cleared and settled among the members of the ACH.
<b>Decentralized bilateral and multilateral agreements</b>	<b>Clearing and settlement occur directly on an agreed path between two payment service providers respectively two institutes. Here the SEPA schemes must be followed as well.</b>
<b>Internal clearing and settlement</b>	<b>Direct internal clearing and settlement within an institution, a group of companies or within an association of institutes. It is needless to say that this form is also subject to the requirements of the SEPA schemes.</b>

EPC lists SEPA-compliant CSM organisations on its Website according to schemes (SCT, SDD Core, SDD B2B and SCT Inst). These are banks and payment service providers who act as solution providers.



## *So far so good. This is where TIPS comes into play.*

In order to support Instant Payments, the Euro system introduced TIPS (=TARGET Instant Payment Settlement). This corresponds to the requirements of the European Retail Payment Board of December 2014, which claims that at least one pan-European solution for Instant Payments must exist by the end of 2017. This will be implemented through the Eurosystem in the form of TIPS.

The goal is to provide a solution for an immediate and finalized settlement with central bank money on a 24/7 basis. Furthermore, the liquidity held within TIPS is counted towards the minimum reserve and the participation is voluntary. All Payment Service Providers, who are authorised to open a TARGET2 account, can participate in TIPS. At least for the first two years, the settlement will be offered to the participants for 0.2 cents per transaction, which is cheaper than a normal SEPA transfer (at the Deutsche Bundesbank), which inquires a 0.25 cent fee.

Beside the financial aspect, another factor is much more important:

The direct provision of money, in the form of central bank money, ensures that the risk of the instant payment transaction for the recipient bank no longer exists. Thus this important factor, which was left open within the body of rules and regulations, is clarified for the participants of TIPS. SCT Inst participants, who cannot or do not want to operate a TARGET2-account, also have the possibility to use the TIPS-account of a TIPS participant for the settlement of instant payments through a contractual agreement.

The interoperability between TIPS and CSMs, such as the already mentioned Automated Clearing House, as well as between the different CSMs remains to be seen. Concerning this, the Eurosystem conducted a market consultation earlier this year and subsequently illustrated how the interoperability and coexistence between TIPS and ACHs can be accomplished.<sup>4</sup>

Finally, we would like to highlight that instant payments represent an opportunity for the banks. However, it is very important to consider the form in which an institution enters the instant payment market and which of the offered solutions are used. As already mentioned, there are a variety of options for the clearing and settlement of transactions and it is necessary to choose the right one. In the event that transactions are not settled in real time, the liquidity management should be analysed more closely and the fraud detection and prevention must always work in real time.

Moreover, most banks have matured structures and core banking systems. For many institutions an immediate and complete change of infrastructure and a transition from batch runs to real time processing and 24/7/365 availability would be a huge effort. In this case, an instant payment gateway can remedy the situation by immediately processing the transactions and maintaining the connection to the CSM even when the legacy systems are offline. When the legacy systems are available again, the gateway can synchronise all the transactions that have occurred in the meantime with the bank's legacy systems.

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<sup>4</sup> [https://www.ecb.europa.eu/paym/pdf/consultations/tips-coexistence\\_of\\_tips\\_with\\_other\\_instant\\_payment\\_services.pdf](https://www.ecb.europa.eu/paym/pdf/consultations/tips-coexistence_of_tips_with_other_instant_payment_services.pdf)



In addition, the transaction volume that needs to be processed can increase rapidly.<sup>5</sup> The own solution should be therefore well scalable and leave room for improvement.

Unsurprisingly, there is no solution that suits everyone. In fact, it is up to the banks to analyse their own infrastructure and to determine which solutions are appropriate for which kind of transaction.

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<sup>5</sup> <https://www.europeanpaymentscouncil.eu/sites/default/files/KB/files/EPC004-16%202017%20SCT%20Instant%20Rulebook%20v1.0.pdf>