

Market Commentary

Using open banking to reduce Bacs risks

Improving the Direct Debit process to reduce errors and save time

The Bacs scheme continues to grow, with Bacs reporting 4.5B Direct Debit transactions totalling more than £1T made in 2020. It gives payers a hands-off way to process their regular payments, while giving corporates an affordable and effective way to control their collection cycle.

Limitations of the Direct Debit scheme

While the Direct Debit scheme handles an incredible volume of payments, it isn't without shortcomings. One of the key problems is getting a successful first payment. There are several issues that a corporate must contend with:

1. **A large number of first payments are not successful.** This can be caused by the Direct Debit Instruction being rejected, meaning the corporate can't even attempt to collect the payment,

or the first payment itself is rejected by the payer's bank.

2. **There is a significant delay between signing up a new customer and receiving their first payment.**

That is, assuming the transaction doesn't fail during the first step, and the Direct Debit is successfully collected. This is due to the notification periods required and the way the Bacs scheme handles transactions and rejections.

3. **Corporates need to contend with indemnity claims,** which are higher on the first payment.

These limitations put the corporate at risk of financial loss if they have already supplied goods or services to the payer (or non-payer in this case).

It also generates work to resolve the problems and increases costs for the corporate:

- Contacting customers to check bank details or collect the payment by another method can be time consuming.
- Collecting missed payments by card can incur higher fees than collecting by Bacs.
- They run the risk of customers deciding to cancel when contacted.

Thankfully, there is now a way to mitigate these issues using open banking.

About the author



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Sr. Product Manager

Liz has worked at Finastra for nearly 20 years (starting originally with Accountis Europe, a startup in North Wales, now part of the Finastra group), joining to co-create their first Bacs product. She started her career as a software developer, but her passion for translating customer requirements into developer specs and quality software solutions, meant a move to product management was inevitable. With a keen interest in UK payments, Liz is the face of Finastra's Financial Messaging Marketplaces business for corporate payment services.



What is open banking?

Open banking benefits customers by enabling banks, third parties and technical providers to exchange data simply and securely.

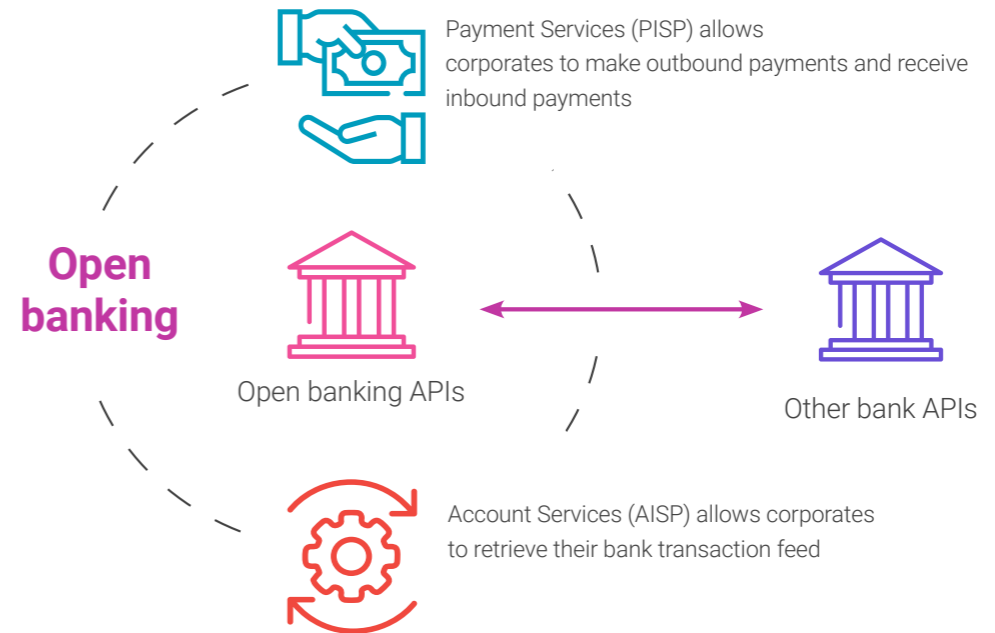
The functionality available includes downloading banking statement data to aid reconciliation, as well as facilitating both inbound and outbound payments.

How can open banking improve the Direct Debit process?

Although not a replacement for Direct Debits, open banking provides a route for corporates to make ad hoc payments as well as receive payments from their customers. Using these methods, open banking can be used in two ways to reduce Direct Debit risks:

- 1 Taking the first payment using open banking
- 2 Performing a "penny test"

How open banking works



First payment by open banking

Taking the first collection using open banking tackles the issues associated with the Direct Debit first payment: failure of the first collection, delay in receiving the payment and risk of indemnity claims.

The process: When the customer chooses to make their first payment using open banking, they select their bank from a dropdown on the corporate website and follow the open banking payment journey. This takes them through their usual online banking login process, then asks them to select which of their bank accounts from which to make the payment. They confirm the payment and are returned to the corporate website. On return to the corporate website, the bank sort code and account number included in the open banking payment details can be used for future Direct Debits if the customer agrees.

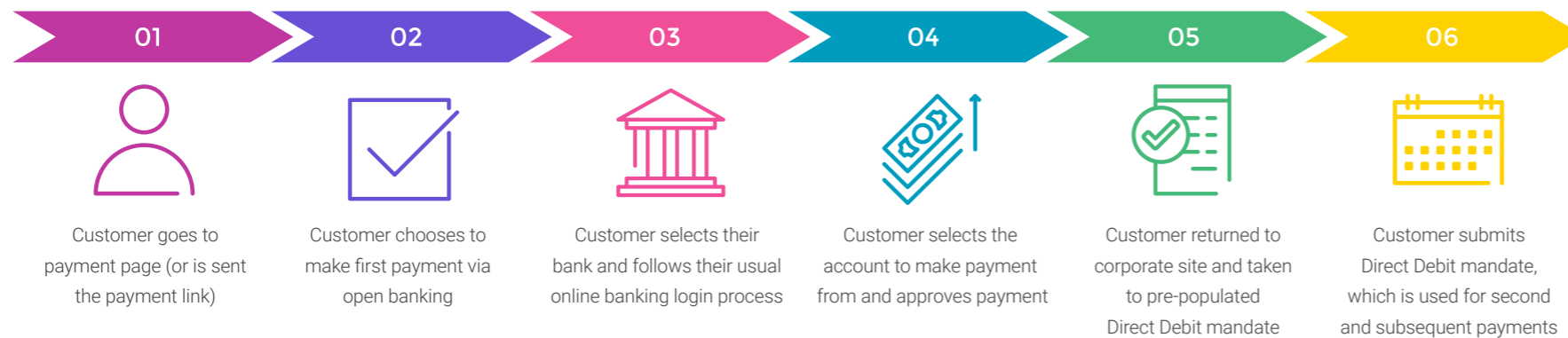
The benefits: The bank details that are returned can be used to pre-populate the Direct Debit mandate, which ensures that the details have been entered correctly – meaning the mandate can be successfully lodged. The other key advantage is that the corporate receives the funds without needing to wait for the Direct Debit process or incur costly card processing fees.

For the customer it is an easier journey – they don't need to enter their bank details, they just use their usual online banking sign-in method.

The limitations: There may be some reluctance by the customer to make payment via open banking; although becoming more common, it is still a relatively new payment option. There is also a disadvantage for the customer that the payment isn't protected by the Direct Debit guarantee or card payment protection, but as it is for only a part of the overall payment this may be acceptable.

Additionally, open banking and the penny test method, both require the customer to have access to online banking.

First payment by open banking process



Performing a penny test

For those reluctant to make the first payment by open banking, the penny test gives corporates another option to reduce their risk by checking the bank details a customer has entered in the Direct Debit mandate.

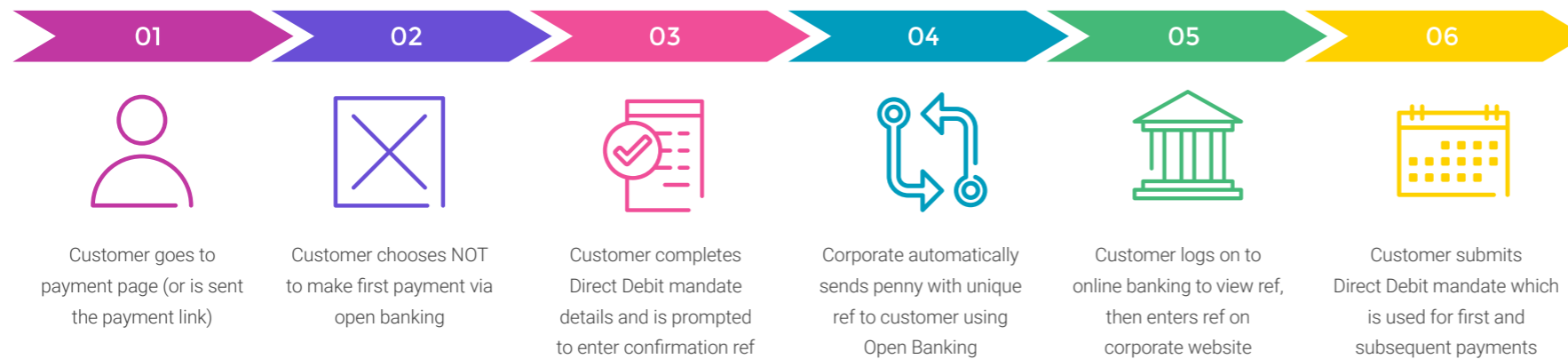
The process: The customer enters their bank details into the Direct Debit mandate on the customer website and submits it. The corporate then automatically sends a penny transaction with a unique reference to the bank account entered by the customer. The customer logs onto their online banking portal to view the penny transaction. They enter the reference number from the transaction into the field waiting on the corporate website; this confirms to the corporate that the bank details used were correct and they can lodge the Direct Debit mandate.

The benefits: While this doesn't reduce the time for the first collection to reach the corporate, it will reduce the number of rejected Direct Debit Instructions and failed first payments, as well as decreasing the likelihood of indemnity claims.

The penny test can be used when making the first payment to a new beneficiary too, ensuring that the account the corporate is sending the payment to is correct before the bulk of the payment is made.

The limitations: As discussed above, this method requires the customer to have access to their online banking portal, so it isn't suitable for everyone. It also incurs a small transaction cost for the corporate, so it may be better suited for high-volume or high-risk situations.

Penny test process





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Conclusion

While there are some limitations with both methods, either – or both – of these solutions can be used to reduce the Direct Debit risk for corporates. Both options can be offered to customers, allowing each user to select the route with which they are most comfortable.

Coming soon!

Finastra will be launching our corporate open banking solution shortly. This can be used in conjunction with Fusion Bacsactive-IP to reduce Direct Debit errors – and cut the work and costs those errors can incur.

In addition, the open banking solution can be used as a cost-effective alternative to collecting payments by card. It also allows corporates to download their bank transactions for importing into their accounting solutions to aid reconciliation.

About Finastra

Finastra is building an open platform that accelerates collaboration and innovation in financial services, creating better experiences for people, businesses and communities. Supported by the broadest and deepest portfolio of financial services software, Finastra delivers this vitally important technology to financial institutions of all sizes across the globe, including 90 of the world's top 100 banks. Our open architecture approach brings together a number of partners and innovators. Together we are leading the way in which applications are written, deployed and consumed in financial services to evolve with the changing needs of customers. Learn more at finastra.com

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