

The Revolution Within: Opportunities and challenges across the global payments landscape

No matter where you look within the payment processing value chain, rapid technological advances and large-scale regulatory initiatives are working to transform the payments industry. That means for financial institutions and larger corporates alike, challenges and opportunities abound.



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Few industries today are undergoing a more rapid and transformational change than the global payments industry. Once viewed as a staid yet fundamental component of most banks' core mission, today payments are being looked at with a fresh eye by participants all along the value chain. And for good reason. Payments and other transaction services, such as cash management, card issuing and credit financing, are critical to the economic health and customer relationships of most banks and many large corporates. In fact, payment transactions are the backbone of the world economy, accounting for 325 billion transactions worldwide.¹ Yet, in some ways, this piece of the business has been neglected over the years, looked at primarily as little more than a way to ensure low but steady margins and necessary liquidity.

Today, however, the game is changing. For one, the cost of payment processing can be considerable, with cash, the most common payment method, also the most expensive and least secure. At the same time, the global recession and technological advances have elevated payments processing to the top of priority lists for banks, corporates and entrepreneurs alike, all eager to find greater efficiencies, better ways of doing business and new markets to serve. Recent regulations and governmental initiatives, such as the Single Euro Payments Area (SEPA) and the Payments Service Directive (PSD) in Europe, and recent NACHA rule changes addressing mobile payments in the United States, are further rewriting the rules for payments. And consumer demand for newer, more convenient yet still secure payment mechanisms are driving visionaries and established players alike to develop new solutions. Together, these forces are working in concert to reshape the entire payments landscape across the globe.

But for all the opportunity that awaits, challenges abound. With historically low margins and high costs, payments processing is a not market for the weak or faint-hearted. Throw in recessionary pressures, increased regulation, rapid advances in technology and new market participants, and it's clear the competitive landscape has fundamentally changed. As a result, banks and corporates will have to commit considerable effort and resources on operations that were once taken for granted, and be at the top of their game to meet the challenge of rising innovation. At the same time, identifying a trusted partner with expertise in the payments arena can help navigate tomorrow's landscape and be a key to managing the payment revolution.

1 Figure extrapolated from historical data.

The End of Cash?

In recent years, talk has heated up about the coming of a “cashless society,” one built on a range of mobile, electronic and alternate payment systems designed to do away with cash as a means of payment altogether. And it’s true that cash, as a basis for transactions, is under unprecedented pressure of late. The European Commission, for example, has calculated that the total costs of all payment methods, including cash, cheques and payment cards, to equal 2 to 3 per cent of a country’s GDP, with two-thirds of the total cost due to cash.

Similarly a pan-European study by McKinsey & Company estimates that society spends around €200 per person per year to cover the costs of cash, while the Dutch Central Bank calculates a figure of €300 per family, per year. Cash is also inherently insecure, vulnerable to counterfeiting and the lifeblood of underground economies of countries around the world.

While predictions calling for the end of cash have been around for decades, however, they have yet to be proven correct. Instead, the market today is demanding a new paradigm be built alongside the current infrastructure that offers consumers, corporates and service providers a range of choices in convenience, security and cost beyond simple cash or credit cards. This new paradigm—or series of paradigms, each driven by a different technological platform and market segment—is fast moving and fragmented, and presents serious challenges to the way banks and larger corporates currently do business.



From Paper to Electrons

Take e-money, for example. While mechanisms such as direct deposit and Electronic Funds Transfer (EFT) have been in operation for years, a new generation of providers is looking to upend the current system by bypassing banks and other intermediaries altogether. One of the largest and most noticeable of these is PayPal, the micropayment system best known as the payment mechanism of choice for online marketplace eBay.

In 2009, the company opened up its platform to developers, essentially offering anyone the opportunity to build an application that used PayPal as its payment provider. Within a few months, thousands of developers had created a host of new payment services, such as a Japanese software developer that added a “quick pay” button linked to PayPal on its application to help people comparison shop, and a call-center outsourcing firm that built an automated invoicing, time-tracking and payment system for its clients based on PayPal.

Other examples of innovative e-money solutions are multiplying. Twitter co-founder Jack Dorsey is touting Square, a candy-sized device that lets anyone accept physical credit card payments through a smartphone without a credit card reader. Obopay, which has received funding from Nokia, allows phone owners to transfer money to one another with nothing more than a PIN. Social media giant Facebook is building payment system for virtual goods purchased on its network, and Amazon.com and Google are freely distributing shopping cart technologies to allow Internet retailers to process payments cheaply.

In the end, each of these products and ideas represents a direct challenge to the global infrastructure currently in place to process payments. Previously, anybody who wanted to create an alternate means of payment needed to navigate a morass of state and federal regulations and licensing bodies, not to mention a range of proprietary systems operated by banks and credit card companies. Today, however, more and more engineers and entrepreneurs are focused on building solutions that bypass the regulatory and risk-management issues—and the banks and payment processors—that once stood in their way.

A Regulatory Push

The payments landscape is also undergoing rapid change in response to a range of regulatory and governmental initiatives designed to address inherent problems in the payments marketplace. Some governments, for example, are outright preparing for the eventual phasing out of cash altogether. The Dutch are preparing for the possibility of a cashless society by the year 2015, while ATM withdrawals in Australia have plunged in recent years. A close cousin to cash, checks, are on their way out in the United Kingdom, as the Payments Council Board has agreed to set a target date of 31st October 2018 to close the central check clearing system.

At the heart of regulatory changes for global payments, however, are schemes designed to harmonize payments across a given geopolitical entity. Two critical examples are SEPA (Single Euro Payments Area) and PSD (Payment Services Directive), created to facilitate payments across the Eurozone.

SEPA began as a self-regulatory inter-bank standardization initiative to break down cross-border barriers to efficient payments by eliminating different pricing structures between cross border and domestic payments. SEPA was specifically created so that the concerns of corporations could be heard and addressed accordingly.

The Payment Services Directive is a regulatory initiative from the European Commission designed to protect the rights of the consumer by regulating payment services and payment service providers throughout the European Union (EU) and European Economic Area (EEA). The goal for both is to increase pan-European competition and participation in the payments industry from both banks and non-banks, as well as to provide for a level playing field by harmonising consumer protection along with the rights and obligations for payment providers and users.

While SEPA is a self-regulatory initiative by the banking sector of Europe (represented in the European Payments Council—EPC) that defines the harmonization of payment products, infrastructures and technical standards, the PSD is driven by regulators and provides for the necessary legal framework within which all payment service providers will operate. The market rules defined in the PSD describe which type of organizations can provide payment services. Next to credit institutions (i.e. banks) and certain authorities (e.g. Central Banks, government bodies), the PSD mentions Electronic Money Institutions (EMI), created by the E-Money Directive (EMD) in 2000, and also creates the new category of Payment Institutions (PI). Organizations that are not credit institutions or EMI can apply for an authorization as PI (certain capital and risk management requirements apply) in any EU country of their choice if they meet certain capital and risk management requirements, and then passport their payment services into other member states across the EU without additional authorization requirements.

SEPA is already working to reshape the payments landscape for financial institutions and larger corporates by offering greater efficiencies and standardization. However, despite its positive spin, the SEPA initiative has suffered from strong criticism of the SEPA governance structure and the lack of consultation with end-users. At a May, 2010 meeting of the Euro Banking Association, banks expressed concerns about the expense of the project, its sluggish returns and the failure of national governments to support the scheme.

In order to boost the adoption and acceptance of the initiative, a SEPA Council has been created to guide the future development of SEPA. The Council will bring together top-level representatives for both the demand and supply side of the European markets in an effort to foster adoption. The first agenda item is to determine and establish migration end dates for SEPA initiatives, and the Council is expected to meet twice a year for three years to monitor and evaluate progress.



ATM withdrawals in Australia have plunged in recent years

2010



The Dutch are preparing for the possibility of a cashless society by the year 2015

2015



Payments Council Board has set a 2018 target date to close the central check clearing system

2020

A New Paradigm on the Horizon

At the center of this changing environment are the banks and large corporates that make up the backbone of the global payments ecosystem. Each of these stakeholders has different needs, different challenges and approaches change from a different perspective. Nevertheless, they also share some common realities specific to the new payments landscape. For one, the challenges for banks are acute. With the potential for non-bank players offering access to payment systems with greater cost transparency than traditional bank-centered processes, the need for efficiency and innovation in payment processing may be the very key to some banks' survival.

In fact, as competitive threats to banks' core payment operations grows, the industry is likely to reorganize along a new payment paradigm, one driven by the willingness or unwillingness for an institution to embrace payments as a core competency. A 2009 report by The SEPA Consultancy, a specialty firm based in London, identified three main tiers of future payments expertise:²

Defensive players

Those banks required to offer basic payments services will do so on a white-labeled basis. These banks will exit the payments business.

Niche players

Payments is a critical, but not a core, business. Sourcing options are high on their agenda.

Market dominant players

Here, payments are a core business. In sourcing is high on the agenda as is the need to achieve scale in order to dominate the market.

This means that to survive, many banks will need to identify better cost savings and new revenue streams. With SEPA, banks can work with pan-European mechanisms for the clearing and settlement of payments, enabling over €10 billion in savings through the consolidation, rationalization and sharing of infrastructures. A further 5 billion may be saved through reduced cash usage as cards, prepaid or other electronic payment transactions increase.

Banks can also generate new revenue streams by moving towards new products and services. Chief among these new models for revenue are mobile payments. As mobile banking services expand from checking account balances to remotely initiating account transfers and bill pay, and most recently to mobile proximity payments, banks and financial institutions are increasingly turning to mobile services to enhance customer loyalty, increase payment processing opportunities and open new markets.

Further, mobile business-to-exchange could be used for payments made by retailers to wholesalers for consumer goods, salary, while commission and pension disbursements to individuals further pen the possibility of enhancing revenues in the payments processing space.

A Changing Dynamic

For corporate treasury functions, the arrival of SEPA has provided many corporates the capability to execute domestic and euro payments in a standard format to their bank, resulting in automated reconciliation, common back office processes and fewer bank accounts. This means corporates can reduce the number of banks required to support their business across the euro zone, while fewer accounts and more standardized processes reduce fees and indirect costs. As stated before, to date, adoption by banks and large corporates to SEPA standards has been spotty at best, as many are reluctant to invest in new technology or the data necessary to participate fully. Nevertheless, the potential for cost savings on behalf of corporates comes in many guises:

Direct per transaction cost savings

The scale economies for payment providers of having to support just one set of pan-European payment instruments could potentially achieve cost savings of 40-50% on their existing payments charges.

Transaction chain cost savings

Corporates with sufficient leverage will derive additional savings from their suppliers' early adoption of SEPA.

Fewer bank accounts and relationships

The maintenance costs of multiple in-country bank accounts will be reduced, while SEPA facilitates smoother liquidity and cash concentration structures, allowing greater overall return on invested cash.

Outsourcing

Companies that choose to outsource all or part of their accounts payable/receivable in conjunction with SEPA could benefit from significant scale economies.

Lower repair costs

SEPA offers the chance to improve end-to-end straight through processing (STP) rates and reduce the attendant costs of payment repairs.

By changing the balance of power and demanding lower fees even as payment STP rises, corporates are no longer simply following the lead of banks when it comes to payment processing. Instead, they are increasingly finding themselves in the driver's seat amid a changing landscape.

² The SEPA Consultancy, Ltd., "The Future of Payments Business: Where do you plan to be 10 years from now?" Ashley Dowson, 2009

The Search for Centralized Control

One of the clearest signals in this shifting balance of power comes in the form of the expanded use of payment hubs as a tool for financial institutions to better serve larger corporate clients. Increasingly, banks are aware that their payment systems are not flexible enough to accommodate client requirements, improve risk management, deliver on operational efficiency, reduce the cost per transaction and respond to changing regulatory requirements. At the same time, corporates are demanding more transparency and control over their own payment processes, and are seeking the tools necessary to maximize payment routing decisions and lower costs.

As a result, banks and corporations alike are turning to payment hubs to help consolidate multiple payment systems or silos into one centrally managed platform, providing the opportunity to better manage payments from origination through instruction management to execution. Not only does a hub help corporates make any type of payment—such as ACH, wire or check—and have payment information routed directly into their accounting systems, a centralized platform can also let customers repair exceptions such as missing information for themselves in close to real time while allowing greater choice in optimizing routing decision-making.

One recent example of a financial institution deploying a payment hub to better serve clients comes from Bank of America, which in 2009 engaged Fundtech's Global PAYplus-Services Platform to create a payments hub that integrates full payments functionality into corporate customers' online experience. The bank's strategic goal is to provide streamlined workflows and increased straight-through processing that better routes all payment transactions from internal systems, host to host, and corporate banking to provide significant improvements in usability and enhance client visibility into payment processes.

To accomplish this, the project includes a client-facing dashboard for more visibility, which gives users more control over their payment instructions and the tools to act on missing input. As a result, clients are engaged in the validation and enrichment of payment transactions to reduce costs and repair time and accelerate payment settlements. Overall, the new platform looks to simplify the issuance of payments, improve visibility and control, and add value to the entire transaction life cycle.

Centralizing operations with a payment hub as employed by Bank of America is one way financial institutions are helping corporations better understand their payment processes. By extracting business value from payment information, banks can also support immediate client requirements and their need to increase payment straight through processing. Furthermore financial institutions can develop additional revenue streams by centralizing their payment processes. Through implementation of a payment hub, revenue streams are realized by establishing specific customer rules that create incentives for utilizing specific transactions. This will provide financial institutions the opportunity to create specific pricing based upon each customer's needs.



Right Partner, Right Now

As the payments landscape consolidates and changes, those competitors still operating in the payment space—along with those newer entrants seeking expertise and guidance—may well benefit from strong strategic partnerships with key suppliers. For banks and corporates alike, that means developing effective sourcing strategies for operations throughout the payments value chain.

According to a 2007 report by CapGemini surveying the global payments marketplace, 58 percent of banks already outsourced or planned to outsource part of all of their payment activities in the next five years. Nevertheless, many banks continue to struggle with this question, particularly in the face of dropping revenues and higher regulation that requires significant modifications in payments processing architecture. For banks facing these challenges, sooner or later a decision will have to be made: whether to invest in rebuilding a fully integrated and future-proof payment process, or make the decision to outsource payment processing functions and concentrate on more profitable banking solutions.

If your organization is facing challenges in the payments arena, you need an experienced partner on whom you can depend. For over 150 years, Accuity has enabled organizations to maximize payment processing efficiency and facilitate streamlined transactions. From ad-hoc payment information look-ups to ongoing maintenance of the data that drives your payment operations, from validation of existing payment files to complete clean-up and even conversion of your legacy payment data, Accuity provides a comprehensive range of flexible solutions that will meet your business's specific needs.

As the Official Registrar of ABA Routing Numbers since 1911 and the official provider of both the Euro Banking Association Priority Payments Scheme central registry and the European Payments Council SEPA adherence database, Accuity maintains the most authoritative payments databases globally. As a result, we can offer you the information you need to ensure that your payment messages contain only the most accurate, thorough data available.

Learn how you can benefit from Accuity's payments expertise.

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