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Payments—Breaking Away From the Core

Business Brief

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Introduction

The payments industry is in a state of rapid disruption, influenced heavily by the ongoing all-pervasive digital revolution. Over the last eight years, electronic payments have reached almost three times their usage and currently stand at around 577 billion dollars a year. Moreover, this trend is expected to grow on an upward spiral over the next few years. Yet only 34% of banks have invested in future-proofing themselves against the oncoming tide of digital payments disruption.

Meanwhile, the scale and speed of adoption of channels and technologies such as mobile wallets, CNP (Card not present) transactions, wearables, and cryptocurrencies are altering the rules of the game. The bank is emerging as the anchor of this rapidly evolving payments landscape. Technology will be the biggest differentiator if banks are to succeed in their new role.

Existing payment systems that function as core banking product processors are not equipped to deal with these complex sets of changes. As a result, banks are at risk if they rely on systems that are not only non-operable with other payments systems but, even worse, complicate the payments value chain with obsolete payments technologies and irreversibly damage the customer experience.

This paper discusses how standalone universal payment hubs built on ISO 20022 are the logical alternative to payments processors locked in core banking systems. It also highlights how these standalone systems can drastically reduce transaction costs and ensure banks remain at the forefront of innovation.

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Forces shaping payments transformation

Demand for instant, invisible, and intelligent transactions

Over the last few years, the industry has witnessed a hyper-acceleration in the way payments are originated, processed, and settled. While payment origination transitioned gradually from anywhere to anytime, the processing and settlement cycle witnessed a rapid shift to 'instant' with over 18 real-time payments going live in the last 24 months.

As a result, banks have seen the need to upgrade payments processing capabilities to meet sharp 4–8 second SLAs and build agility to rapidly implement newer payment flows embedded into shopping and lifestyle experiences.

Widespread adoption of open banking

With open banking further fuelling innovations in the payments space, consumers are driven towards alternative payments providers attracted to the promise of cheaper and faster transactions. Research states that by 2020 over 56% of retail payments will flow through fintechs.

Under the threat of these federated customer relationships, financial institutions have identified API strategies as key levers for differentiation in the market. Today, most banks are revisiting their payments landscape to ensure they are ready for low-risk integration, least-cost processing, and zero revenue leakage.

Harnessing the power of data

Data has emerged as the biggest asset in the financial services world. As a result, regulations such as the GDPR that prescribe data ownership, data handling, and consent-based access to data have the biggest impact on the payments industry.

The adoption of artificial intelligence is considerably altering the payments journey—be it personalized experiences, prediction of payment patterns, or early detection of fraudulent transactions. However, the biggest inhibitor to tap into AI continues to be the ability to access clean data. To build effective machine learning models, institutions need a considerable corpus of standardized data, which can be used to train systems. The implementation of ISO20022 solves the problem of standardization of data across the industry in terms of message exchanges and data models.

New degrees of data transparency across domestic and cross-border flows are emerging with the implementation of initiatives such as SWIFT gpi. With multiple payment rails and trust networks competing for traffic, data transparency will be key for the adoption of such initiatives, especially for corporate and institutional clients.

Tackling the challenges of future digital economies

As volumes and velocity on new age networks rise and emerging economies drive busy trade corridors, regulatory bodies are stepping up their role and ensuring the creation of open marketplaces. They are introducing inter-scheme operability and laying out blueprints of future digital economies. India, Singapore, Australia, and the UK have addressed payments as one of

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the key chapters in a larger digital agenda driven by their respective central governments.

With digital proliferation, the threat of fraud, micro-theft, and account takeover has risen to disproportionate levels. Therefore, the need for better control and monitoring of payments as they move through different channels and systems is a non-negotiable investment to protect one's reputational risk.

Retaining credibility in the payments value chain

Payments have always been the epicenter of innovation. This is the arena where fintechs, big tech, big retailers, non-financial institutions, and even telecom giants compete. While some differentiate based on technology, some on the operating model, and some through differentiated end-user experience, banks can establish themselves as ecosystem anchors with the correct mix of technology and partnership strategy.

To lead the payments ecosystem, banks need a rock solid integration framework bolted or built into their payments processors with ecosystem adapters that can seamlessly plug into payments schemes, blockchain networks, and cloud-based systems. The ability to bundle, unbundle services in addition to offering clearing and settlement services with an intelligent payments chain is what will set the leader apart.

Defining the path to transformation

Initiating the path to transformation in a digital economy

We are in a phase of transient digital evolution where most organisations are grappling to re-innovate their business and operating models. Not reacting to change poses the real threat of failing to retain relevance for the customers of tomorrow.

Forrester, in its report on "Achieving Business Outcomes with Payments Transformation," has highlighted that banks embark on transforming their payments systems for three important reasons:

1. Achieve interoperability with other payment systems

2. Improve customer experience

3. Simplify the payments value chain

Core banking modernization does not address payments challenges

The complexity of core banking systems inhibits change adoption. Simplifying and modernizing legacy core banking systems does little to address IT cost and efficiency. Rather, it impacts the sustainability of the business at stake. It is more a surgical procedure with timelines that run into years and does little for the bank to keep up with the payments environment spanning the advent of fintechs, new instant payment schemes, and regulatory changes

Most of these core banking systems entered banks even before modern programming languages like Java were born. Unfortunately, over the years, they have also been tailored to do far more than they were meant to, compromising processing efficiency.

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Suggested path

Banks that are working towards creating profitable payments cost centers while paving the way for digital enablement and overall business growth seem to be following a pattern. This pattern is essentially a three-step process aimed at transformation. It involves:

- Moving payments out of the core banking system
- Adoption of a centralized universal processing platform
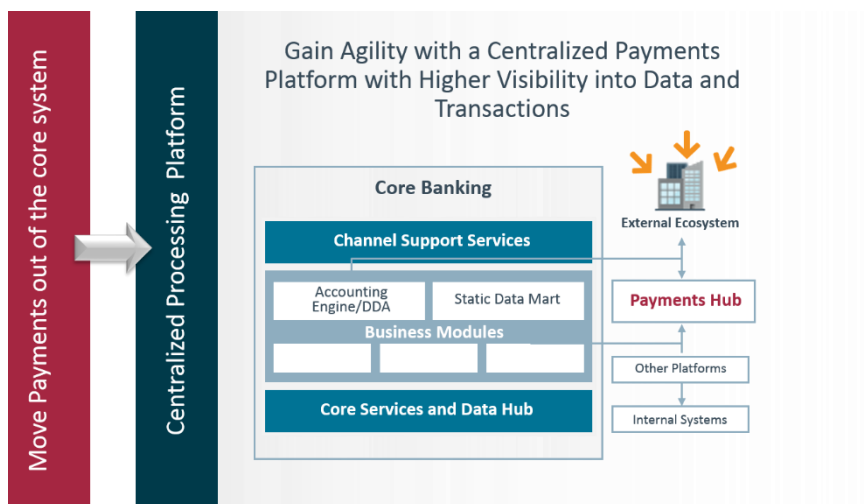- Creating a foundation for payments innovation and ecosystem enablement

Figure 1

Traditional payments embedded in core banking systems fail to deliver the agility, scale, and rapid go-to-market that is currently required to keep pace with industry innovation and competition.

With the advent of digital, core banking systems are being stretched to do far more than account and product management, leading to systemic chokes while trying to deliver powerful cross-channel transaction processing. Most of these systems were built on legacy technology and are not equipped to process the velocity of transactions that come with the digital age. Dated technology renders limited performance tuning capacity and lacks compatibility with the latest tools and industry packages that can easily track, transform, log and manage exceptions.

Most banks who choose to handle real-time payments processing outside the core deal with problems of multiple points of change, lack of centralized data, and traceability. The threat of bottlenecks in the bank's downstream legacy systems also looms large and is often the cause of delays and missed payments. In addition, the lack of a real-time view often translates to customer attrition, fines, and reputational risk.

Adopting an enterprise-wide payments hubs strategy

Reducing technology debt of payments 'patchwork' and improving automation

With the twists and turns the global payments industry has taken, multiple product processors have crept into the bank's payments landscape. Each of these payment processors may have, in their own right, been the best of

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breed and may have involved heavy investments and multi-year implementations. However, the slow and inevitable challenges of integration, data duplication, lack of holistic enterprise payments architecture or investment roadmap have resulted in the accumulation of large technology debts for the bank. There is also a slow but steady vendor risk.

Legacy infrastructure displays high error rates that are sometimes repetitive and involve heavy manual intervention for repairs and managing exceptions. With a single automation platform in place, the rates of straight-through processing can peak beyond 97%. Workforce can be re-deployed from working on mundane repairs to better levels of customer service, better product management, and driving key talent to contribute to strategic programs within the bank.

Meeting industrial-scale volumes with powerful processing capability

Standalone payment systems are often called payments 'hubs' because they act like a pin-cushion. Almost every banking system injects payments into it—be it high-velocity P2P payments or high value B2B transactions. These channel-agnostic processing hubs operate 24x7 with almost zero downtime servicing multiple countries and multiple core banking systems at a time through a single instance of deployment.

Payments processing is completely isolated from the core. Only during account balance checks, pre-checks, and postings does the core come into play. Instruction validation, compliance checks, data transformation, and the orchestration of payloads through multiple interfacing and servicing systems is done by this payments hub, thus shielding the core from heavy load lifting.

Consolidated rich payments data for informed decision making

With the centralization of payments operations comes the perks of data consolidation. Data is standardized in this store and can be logically identified and segregated from source systems and be used for more accurate insights. Further, the standardized data store can be used to work seamlessly with other industry platforms such as an API ecosystem to deliver potential monetization capabilities.

An enterprise-level shared cost centre for processing payments

One of the key goals of payments transformation is to chart out a clear path of technical consolidation and establish a centralized cost center. This allows for centralized change management and de-duplication of systems and workloads.

Creating a foundation for innovation and ecosystem enablement

Speaking the new payments language—ISO20022

ISO20022 ensures business continuity amongst payment rails and financial institutions, facilitating the exchange of money. Large corporates use the same standards to exchange payment and remittance information, and ISO2022 helps achieve seamlessness between the corporate and bank's connectivity along with the choice of doing business with multiple banks. From the bank's perspective, there is a minimal cost for a corporate to move its business to a new bank today, making competition stiff but also fair.

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Operationally, there is a huge cost and manual effort spent in the reconciliation of payments with invoices. ISO20022 establishes a structure in the payments instruction. It makes it systemically easier to reconcile and repair payments leading to more efficient systems, better turn-around times, and easier collaboration between banks and clearing houses.

Building credibility in the SWIFT gpi payments value chain

As the focus shifts from speed to transparency in cross-border payments, it becomes important for the bank to prove its credibility in the value chain while differentiating itself with accelerated turn-around times, better reporting through 360-degree views of payments, 24 x 7 availability, all of this at a minimal cost.

SWIFT gpi enables banks to tap into SWIFT's 50+ market infrastructures through a single window. It allows for better tracking of cross-border payments in over 220 country corridors, ensuring complete traceability and access to payments originated or managed by the bank. Furthermore, it threatens to change the future of correspondent banking with its ability to track payments leading to renewed contracts and consolidation. Establishing credibility in this value chain, therefore, becomes imperative for the correspondent bank.

Building digital adequacy to prepare for tomorrow's hyper-scale businesses

With digitization comes the customer demand for 24x7 self-service. Banks also need to fight cost margins while introducing competitive offerings into the market. With new offerings, new price points, newer business models, and newer entrants, there is always the possibility of a marketplace disruption. And in times like these, banks need to prepare like never before to adapt to a new era of servicing and scale—that of 'hyperscale.'

The nature of 'hyperscale' businesses is such that if banks do not prepare to scale with them, chances are these businesses will start self-servicing themselves. We have seen this in the case of Amazon, Google, and WeChat or even Uber, where alternative P2P payment networks, wallets, and authentication mechanisms have emerged. What banks need in such situations is a payments platform that complements and enables the bank to participate, collaborate, and seamlessly plug into this ecosystem of innovation with a rock-solid ability to scale as transaction volumes rise

Conclusion

Standalone universal payment hubs are the logical alternative to payments systems locked in core banking systems. They are not only being built on the latest architecture but offer the flexibility to incrementally add new functionality and features required to service regulatory and customer mandates with minimal disruption from the woes of system-level change management. Ultimately, they have the potential to drastically reduce transaction costs and enable banks to remain at the forefront of innovation.

Clearly, the need of the hour is for a dedicated universal payments hub that is built on contemporary technology and is robust enough to help address hygiene requirements of banks—preserving the customer experience and simplifying the value chain.

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Sources

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