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WHITEPAPER
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The move towards payments digitization in the US

IT’S TIME TO ACCELERATE

COMPLEXITY SIMPLIFIED

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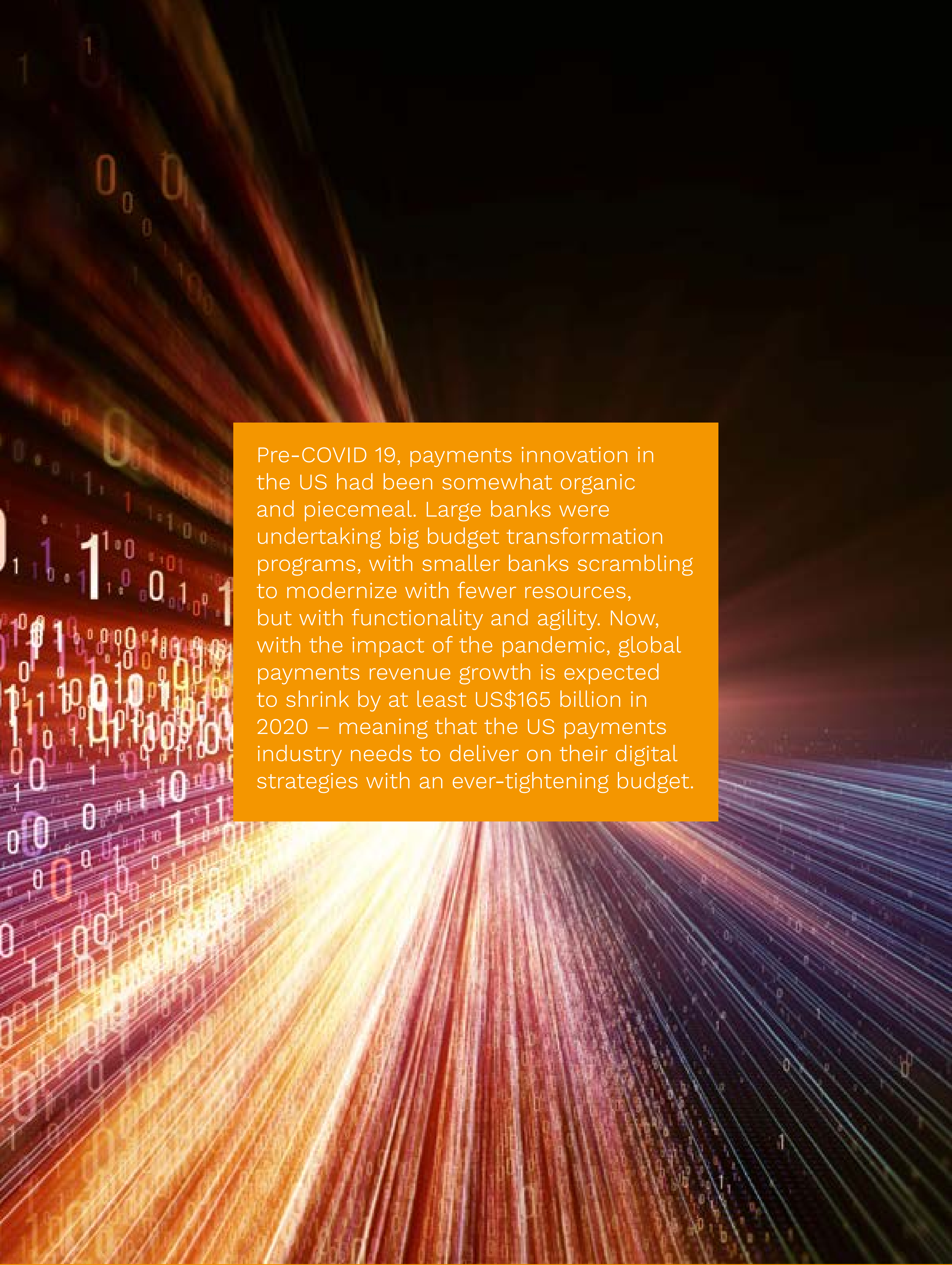

Pre-COVID 19, payments innovation in the US had been somewhat organic and piecemeal. Large banks were undertaking big budget transformation programs, with smaller banks scrambling to modernize with fewer resources, but with functionality and agility. Now, with the impact of the pandemic, global payments revenue growth is expected to shrink by at least US$165 billion in 2020 – meaning that the US payments industry needs to deliver on their digital strategies with an ever-tightening budget.

THE US PAYMENTS INDUSTRY IS RIPE FOR CHANGE

There will be no return to the norms of 2019; the impact on the behavior and expectations of customers and businesses will be profound. In Europe, banks are making shrewd moves to demonstrate their customer centric approach and use of digital technology within this pandemic.

For example, Lloyds Bank in the UK, is providing free digital training and issuing free tablets to elderly customers. Intesa Sanpaolo in Italy is launching pre-approved credit lines to small businesses and families in need, and KBC in Belgium is rolling out wearable technology to all its customers. In the US, however, banks are focusing less on utilizing digital products and more on providing relief to those have been financially affected through traditional mechanisms.

It is critical, not only for the US payments ecosystem, but also for the economy as a whole to develop the payments solutions that will allow economies to emerge from the current crisis and be ready for future challenges. While COVID-19 will have a deep impact on the banking and payments industry, one thing is clear – the US customer will not wait. If anything, the demand and need for digital services is more heightened than ever.

REAL-TIME PAYMENTS AS A STIMULUS FOR CHANGE

Real-time, or instant, payments are the lifeblood of delivering improved customer propositions and there is a reason why they have taken the world by storm over the last five years. They bring together speed, data, and communication to help solve long lasting pain points within the payments market and have proven to be an essential part of any modern payments market.

Real-time payments (RTP) has become a maelstrom of activity in the US in recent years also. All major payments infrastructure providers, including NACHA and The Clearing House, as well as the Federal Reserve System have been engaged on the topic to prepare the US for its arrival. And it is here! Banks should exploit it to accelerate digitalization.

However, many US banks view RTP with uneasiness, as they worry that they could threaten existing revenue streams such as card and wire payments. Existing non-sufficient funds (NSF) checks are also big revenue generators for banks that RTP threatens to upset. Real-time payments, therefore do have the potential to decrease lucrative revenue streams, but by narrowing their focus on these negative effects, banks risk missing out on the myriad of opportunities they present. Perhaps one of the most obvious opportunities is the implementation of the global electronic messaging standard, ISO 20022 (used in The Clearing House RTP system). ISO 20022 is the future of payments messaging standard and can greatly enhance multiple processes including reconciliation via its increased data carrying capabilities. And even more pertinent: in times of emergency, such as COVID-19 and natural disasters, citizens are reliant on federal or state monetary intervention - RTP combined with digital solutions can offer immediate access to funds, with additional data attached.

The Federal Reserve has become frustrated at the lack of progress within the space in the US and is implementing its own system, FedNow, to encourage adoption. This move should signal to banks that they mean business and banks should start acting to adopt and leverage the benefits they bring for digitization.

REAL-TIME PAYMENTS ACCELERATING DIGITIZATION IN THE US ECONOMY - AN EXAMPLE

US healthcare industry

Heavy paper-based processes and costly inefficiencies often force hospitals to chase payments. 15% of healthcare spending is connected to billing/payment inefficiencies. 47% of patients would consider seeking medical treatment at different hospitals with more efficient payment experiences. Real-time payments can address some of these pain points:

- Granting claimants quicker access to funds.
- Helping patients more effectively manage their working capital by initiating payments directly from their bank account, enabling a clearer vision of how much money is available.
- Providing more precour data regarding insurance payments' purposes.
- Enabling healthcare providers on the other end of transactions to receive payments faster and at lower costs (no associated fees like with credit cards).

EXAMINING THE OTHER ACCELERATORS FOR DIGITALIZATION

Aging US population

COVID-19 is not the only reason for banks to look at their digital offerings. The US population is aging. The number of Americans aged 65 and older will more than double over the next 40 years meaning there will be a ramp up of Gen Z citizens that will be of banking age and digitally native. Gen Z have been born into new technology and they have also been defined by it more than any other generation. The iPhone launched in 2007, when the oldest Gen Zers were 10. By the time they were in their teens, their primary means of connecting with the web was through mobile devices.

Banks must look at the impact this will have on their longer-term digitization strategy and be able to segment what this customer base might want and how they will interact. One out of two consumers over 35 chooses a primary bank based on the local presence of a branch or ATM. This falls to 30% for consumers under 35[1]. Additionally, this younger demographic values recommendations from friends and family more than from a bank, with more than 50% of consumers under 35 saying they will open a primary bank account based on a trusted referral. Combined with this, younger generations don't view a checking account as the starting or central point for their personal finances. A bank may have more success targeting younger individuals with a combination of financial management tools and rewards rather than better interest rates for example.

By offering enhanced "Digital" channels, it provides an easier on-ramp, resulting in greater consumer choice over financial products. Institutions that rethink their customer acquisition to understand different generational tendencies across an entire set of product relationships will be better positioned to expand their footprint and wallet share over the customer's lifetime.

Competition from non-banks

By 2022, it is expected that at least one in two transactions is likely to flow through channels not owned by banks but by FinTechs, and other third-party interfaces, thanks to more open infrastructures and the rise of digital channels[2]. While disruptors have been innovating on customer experience and products, incumbents have historically enjoyed the advantage of consumer trust. The recent US Digital Payments Survey by McKinsey indicates that this advantage is eroding - consumers have become more comfortable entrusting their financial transactions to non-banks. Therefore, banks need to be in a position to offer something different to remain competitive. These mobile wallets and payment apps are also collecting rich customer data that their parent companies use to personalize and optimize customer experiences – resulting in a greater threat to banks.

By enhancing their digital channels, banks can provide an effective gateway to emotionally connect to its consumers. Technology companies that are consumers' favorite brands not only have best-in-class digital capabilities, they also do a superior job integrating digital and physical environments, and integrating both strategically to foster an emotional connection. This is largely based on harnessing the vast amounts of data collected on their customers, to better understand them and therefore be an intrinsic part of their lives.

For data to become the cornerstone of a banks' customer relationship and own internal digital economy, breaking the channel silos is crucial. Branch, ATMs, online, mobile, and call centres all need to be connected, along with third-party digital assistants such as Google Home and Amazon Alexa. But merely collecting data is not enough; mining and extracting value from this data will be a decisive differentiating factor for banks and other players looking to compete and take their customer propositions to the next level. However, according to Icon Solutions' recent whitepaper research The Race to Payments Transformation published alongside Aite Group, only 18% of banks report that they are in the process of shifting from a transactional revenue model to a data driven revenue model.

[1] PwC: 2019 Consumer Digital Banking Survey: The ever-changing consumer [2] Payments Cards & Mobile: 12 Trends Reshaping Banking in 2019

Corporate requirements

Corporate treasurers are not just business customers—they are also consumers. And their experience of seamless, immediate payments in their private lives is shaping their expectations in the workplace. This resulting shift in mindset is seeing corporate clients demand the ability to transact in a real-time, omni-channel environment, 24x7.

However, this expectation is not matched with reality. Check usage for business-to-business (B2B) transactions in the US was at 42% in 2019[3]. There are barriers organizations face in moving away from checks, such as increased costs of transitioning to alternative payment methods and lack of IT resources, as well as difficulty convincing business partners to shift towards sending/receiving electronic payments rather than checks. In addition, the relatively high level of integration of checks in corporate accounting systems contributes to their continued usage.

Corporate treasurers stand to benefit from enhanced liquidity management and transparency; greater control over payments; and enhanced data for reconciliation purposes. However, it is not just corporate treasurers that can drive value from payments digitization. In a time where consumers have been unable to frequent shopping malls and restaurants, offering digital alternatives to customers must be at the forefront of a corporates mind. Business-to-Consumer treasurers can look for new ways to offer on-the-spot credit, payment instalment plans and refunds. In turn, this should improve customer service, drive customer retention, and attract new business.

[3] Association of Financial Professionals: 2019 Electronic Payments Survey

CREATING A PAYMENTS STRATEGY FIT FOR DIGITIZATION AND BEYOND

As we move further into the 21st century, customers will expect US banks to provide services that are imbedded in their daily lives and banks need a strategy that will enable them to capitalize on this.

Pursuing a digitization agenda should not just be the realm of large Tier 1 banks. Considering that banks spend about $350 per account in annual costs[4], understanding what forms the epicentre of the bank-consumer relationship can influence profitability over the longer term. With increasing pressure on margins due to COVID-19, delivering enhanced customer proposition on less budget is of paramount importance. Smaller and more regional banks are perfectly placed to take advantage of modernization in payments technology to provide flexible, advanced services for their customers. While existing revenue streams are entrenched in the smaller regional banking business model, 21st century banking means that merely offering a credit/debit card is not enough. All banks, no matter the size, need to offer a broad digital service platform that add value to both the customer and the bank.

A digitization payments strategy can enable the bank to offer new services to their clients as well as generate internal efficiencies e.g. protecting annuity and gathering deposits. We have identified six key considerations that are crucial for any payments strategy:

→ DEVELOP A 'COLLABORATIVE PLATFORM' MINDSET

Decoupling banking services away from the core and opening it up to both consumers and FinTechs allows for new partnerships, and innovation. In addition to helping retain customers, open ecosystems can provide traditional banks with a revenue boost.

→ FLEXIBILITY AS A CORE PRINCIPLE

It is of critical importance that banks manage new service implementations in a way that can generate revenue. Continuing to plan, budget for, and build out their physical and digital infrastructure – transformation should be a continuing cycle. Players need to launch products and services that attract customers in a matter of days and weeks, not months and years.

→ ENSURE ORCHESTRATION AND INTEGRATION

Essential for leveraging new functionality. The more a bank provides via digital channels, the more the back-end needs to be orchestrated effectively. An orchestration engine is vital so as banks can take advantage of new technology, quickly and efficiently and plug-in to newly developed infrastructures. Banks need a strategy to ring fence and simplify architecture-driven transformation.

→ COMPREHENSIVE DATA STRATEGY

Banks need a data strategy that can enable them to extract value from data at rapid speed and scale. This should include aspects such as governance, storage, access etc.

→ STANDARDS AS A NECESSITY

Standardization should be at the core of any digitization program. Industry standards such as the ISO 20022 messaging standard enable banks to not only truly compete with Big Tech companies but also better work with third parties, remain agile, as well as streamline their own internal processes.

→ LEVERAGING REAL-TIME PAYMENTS

They need to be the beating heart of any payments strategy, with ISO 20022 as the connective tissue allowing the data to be passed rapidly, in a standardised format.

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[4] PwC: 2019 Consumer Digital Banking Survey: The ever-changing consumer

From our experience, transformation does not need to take years, but can be incremental, constantly delivering to the end customer. Our typical payments technology strategy engagement can unlock business value in 10 weeks:

SCOPE	STAGE 1 WHY	STAGE 2 WHAT	STAGE 3 HOW
CONTENTS	PAYMENTS TECHNOLOGY STRATEGY: CONTEXT & DRIVERS	PAYMENTS TARGET ARCHITECTURE & GUARDRAILS	PAYMENTS TECHNOLOGY ROADMAP & BUSINESS CASE
	• Reviews the need for a renewed strategy, taking into account regulatory activity, market / technology trends, current payments landscape and challenges • Addresses the internal and external drivers and leveraging Icon's Payments assets • Establishes KPIs to measure the success of the payments strategy	• Delivers the end-state target architecture • Defines architecture building blocks to support the strategy • Sets the architecture guardrails • Leverages Icon's payments blueprint, taking into account the defined strategy	• Proposes a transition roadmap for migrating to the target architecture, defining the business value for each state • Defines transition architectures for the interim states, highlighting the impacts on the current architecture • Documents business value realized
EXAMPLE TIMESCALES	3 WEEKS	4 WEEKS	3 WEEKS

CONCLUSION

Until the recent TCH Real-Time Payments (RTP) system, no new infrastructure had been built in the US for forty years. As a result, current payments legacy systems have reached their limits to support the requirements of modern commerce. Anytime, anywhere payments are here, and customers – individual, SME and corporate – need to be supported in taking advantage of the digital economy.

The implementation of RTP and the upcoming FedNow system means that US banks now have the infrastructure necessary to advance digital products, and banks of all sizes can exploit its benefits. But it requires innovation not trepidation. Banks must alter their mindset towards a holistic, long-term view, with 'quick-wins' along the way, ensuring they remain flexible and agile. Payments digitization is an essential part of any bank's future strategy to ensure they can continue to offer increasingly sophisticated digital services to their customers.

In the aftermath of COVID-19, banks also need to look at alternative revenue sources rather than loans and deposits, and payments has the ability to be one of those sources. By having a robust digitization strategy in place that will ultimately lower the cost of ownership, banks can continue to remain fiercely competitive. Providing digital channels that enable banks to offer additional value added services that are valuable to their customers' lives and experiences is the key to unlocking greater return on investment as well as customer satisfaction.

ABOUT ICON SOLUTIONS

Icon Solutions provides world class payment and enterprise solutions to the global financial services sector. Clients include leading international institutions such as BNP Paribas, HSBC and Lloyds. Whether it be assessing payments systems, producing transformation roadmaps, or simply providing subject-matter expertise, Icon enables clients to be leaner, innovative, and responsive to the demands of the future.

If you would like to find out more about how Icon can accelerate payments transformation, call us on **+44 (0)20 147 9955** or email **info@iconsolutions.com**

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