



Payments Core

Moving Payment Services Out of CORE Banking - Payments Unplugged



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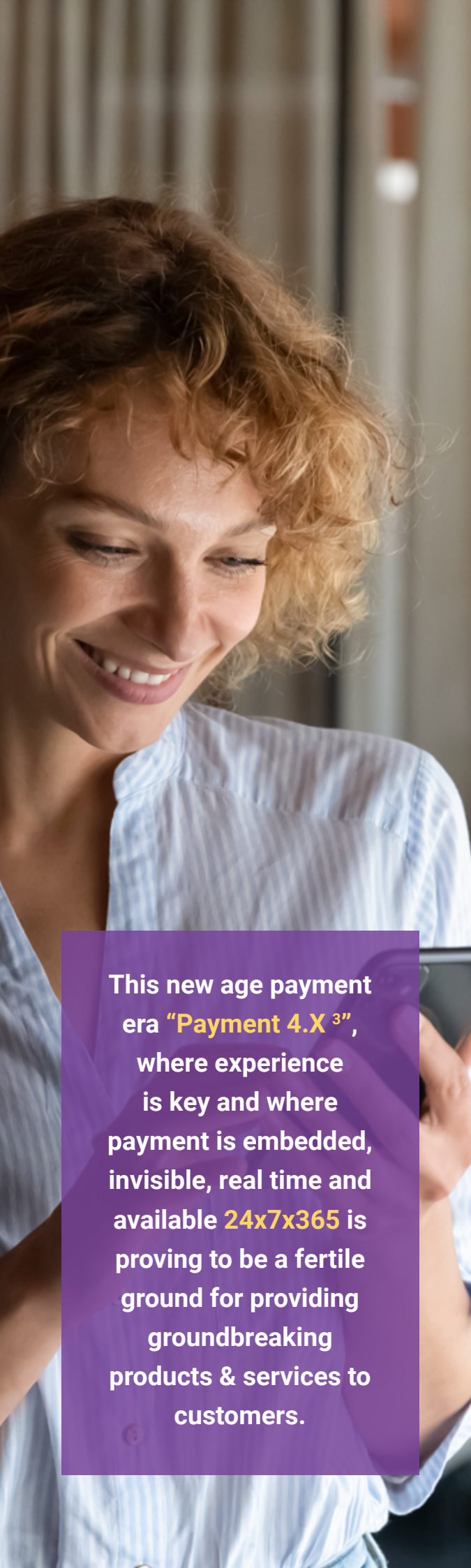
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This new age payment era **"Payment 4.X³"**, where experience is key and where payment is embedded, invisible, real time and available **24x7x365** is proving to be a fertile ground for providing groundbreaking products & services to customers.

1. Introduction:

The Global Payments Revenue is expected to reach **\$2.5 trillion** by **2025** overcoming the pandemic induced decline in 2020/2021, when revenues stood at **\$1.5 trillion¹**. With new digital payment offerings, Global Non-Cash transaction volume is expected to grow by **18.6% CGAR** (2020-2025F) and is projected to reach **\$1.8 trillion** in transaction volume by the end of the forecast year².

Payment Industry has been evolving rapidly over the last **10 years** and the COVID pandemic has further accelerated innovation, shaken incumbents, and introduced new-age, innovative players into the Payments Space. The need for Contactless, Digital and Realtime payments has never been so acute.

Existing Payment Systems in established banks that are tightly coupled with the CORE banking product/processes are not equipped to cope-up with the multi-dimensional change, rapidly evolving payment ecosystem and are at risk of revenue erosion from new entrants. This is more evident as Payments become more embedded in the customer journey. Fintechs today account for roughly **5%** of banking revenue in the US and as much as **20%** in payments-related fields⁴



2. Drivers in Payment Transformation

2.1. Open Banking

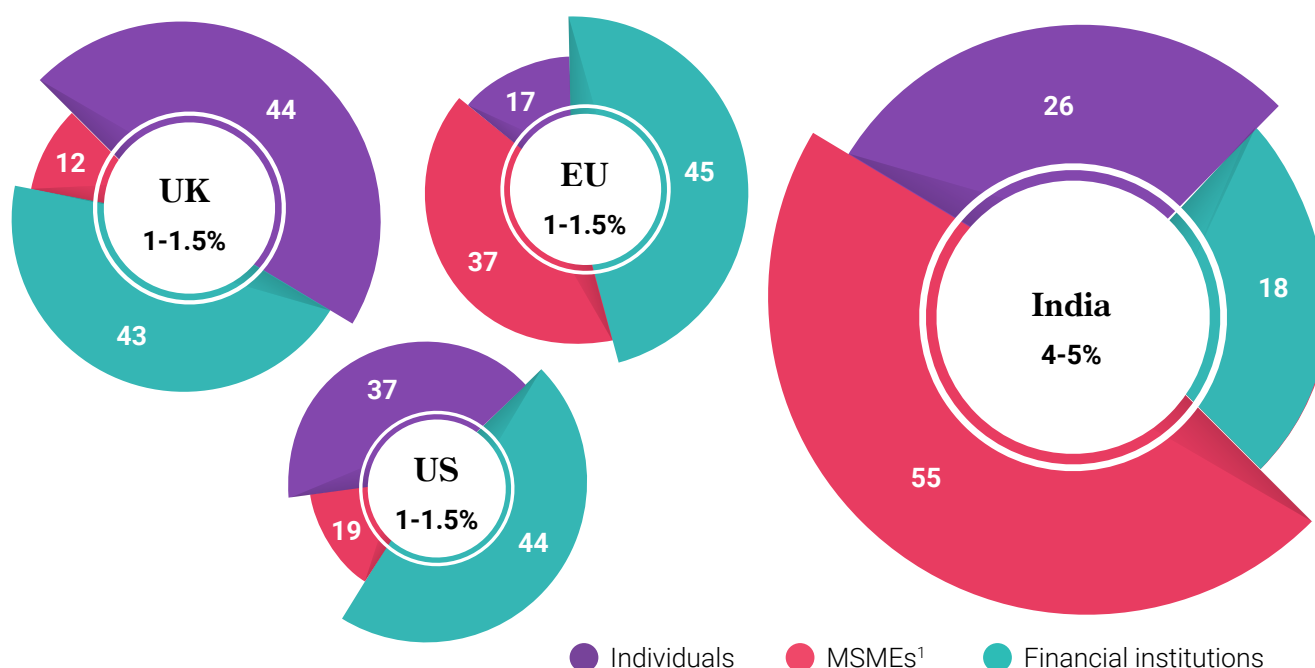
With Open Banking already live in EU and UK and Open Finance being kickstarted around the globe, the traditional payment instrument mix (Cash, Check, Debit/Credit Card) is gravitating towards a Digital Payments ecosystem⁵, with a possibility of disrupting the deeply entrenched card networks (VISA, Mastercard etc). With the Central Banks' mandate of making bank customer data and transactions available on demand, EU and UK banks already have made the Customer Master Data available as a shared service.

The most valuable commodity in the world now is Data and Financial Data is one of the most sought-after commodities.

McKinsey predicts the share of Open Financial Data to be between **1% to 5%** of GDP.

The potential GDP impact of open financial data and the share accruing to different market participants varies by region.

Potential GDP impact by 2030 by broad attribution to market participants, % of GDP



¹ Micro-, small, and Medium-size enterprises, defined by the International Finance Corporation as enterprises with sales and/or assets less than \$15 million and/or with fewer than 300 employees.

Note: The GDP impact for each economy in 2030 is estimated using MGI's Global Growth Model (GGM), a dynamic general equilibrium economic model spanning 100 countries; GGM estimates the economy-wide potential GDP impact by 2030 of 24 banking and payments use cases, each of which individually generates economic value. The attribution of potential economic value across market participants is estimated based on the potential impact of the 24 use cases on a standalone basis, without taking into account dynamic macroeconomic feedback loops that determine GDP impact. Figures may not sum to 100% because of rounding.

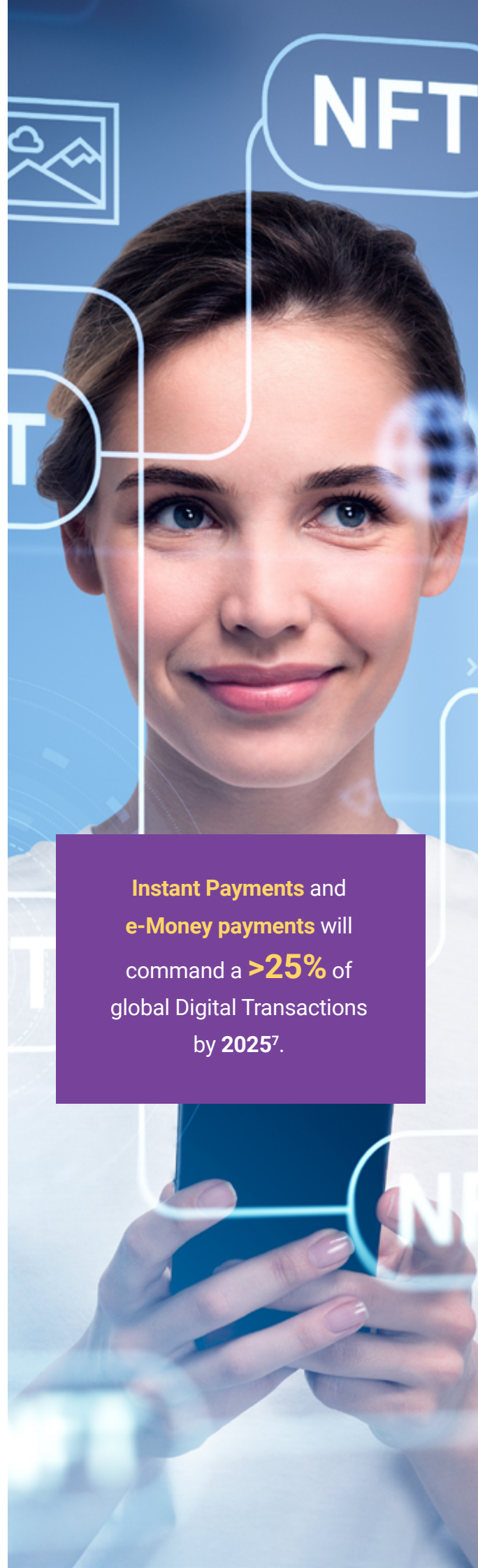
Source: McKinsey Global Institute analysis

The possibilities of shared financial data services are tremendous and one being the application of AI in predicting customer payment patterns, early detection of fraud and hyper personalized experiences. The advent of **BNPL** (Buy Now Pay Later) services that harness this power is already shaking the traditional lending models based on credit scores. The innovation spree will continue with more geographies adopting Open Banking and Open Finance in general. Payments businesses represented nearly a quarter of all fintechs launched and funded from 2015 to 2020⁶. However traditional banks that have evolved over many decades, built on legacy platforms with disparate messaging standards will find it hard to standardize, rationalize and mine data successfully. To this effect the adoption of ISO2022 will help standardize data.

2.2. Real Time Payments

40 Real-Time Payment systems going live in the last **5 years** and **8 going live in 2020** alone is a testament to the market forces driving change for instantaneous payments.

e-Money accounts offering blazing fast payment options, are already attracting B2B customers and is heralding a new era of D2C model. This hyper-personalized, rich end-to-end-payment experience driven by a customer centric approach, empowered by go-to-market agility, built on an Open Ecosystem and powered by intelligent API business models is challenging Big Banks to defend and extend client opportunities.



Instant Payments and **e-Money payments** will command a **>25%** of global Digital Transactions by 2025⁷.



2.3. Near Real Time Cross Border Payments

In the global remittance and consumer cross border payments space, the introduction of **SWIFT GPI** has resulted in cross border payment settlement times being slashed from **3-5 days** to within a day, thereby enabling better cash flow prediction, immediate liquidity management and has helped reduce payment costs. With SWIFT GPI connecting more than **141 countries** representing over **56%** of SWIFT's total cross-border payments traffic volume⁶, this is a quantum leap in reduced processing times. The adoption of SWIFT GO, which intends to further reduce the settlement time to within seconds, will further revolutionize the often-neglected cross border remittance space. SWIFT GO will enable faster global remittances, incubate innovation in cross border payments, heralding new players into the game.

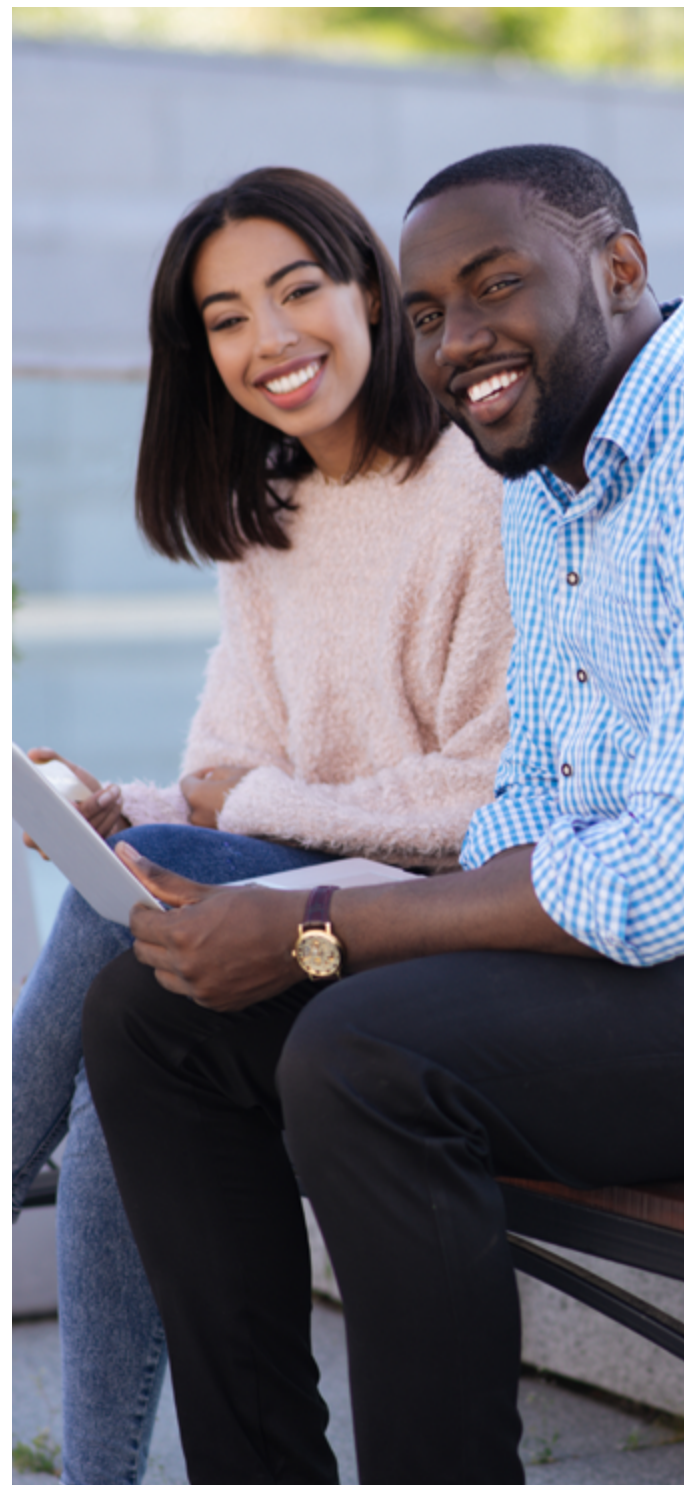


3. Challenges in Core Banking Modernization

A Bank's Payment Estate typically consists of Payment Initiation, Payment Processing and Core Banking Payment Systems. Payment initiation channels have proliferated and so has been the adoption of key market trends such as adoption of an omni channel payment strategy. Similarly Payment Processing has taken significant strides, with the move from legacy Payment Engines to Enterprise Payment Hubs. While the presence of a single vendor Payment Hub is the norm in banks, the future trend in Payment Hubs would be a collection of best in breed services that are highly configurable, scalable and interoperable.

However CORE Banking continues to be megalithic, built over decades of customization and exhibiting a significant inertia to change. As a result, recent CORE banking modernization efforts have been largely restricted to single vendor product modernization, leaving the largely peripheral batch processing systems intact. A combination of factors, such as risk appetite, and taming the unknown are responsible for holding back true CORE modernization efforts. And banks are right in adopting a cautious approach.

Traditional Payments deeply embedded in CORE banking systems are not able to deliver key changes (discussed in the drivers section) at the required agility, scale and velocity. Banks who are able to deliver real time payments at scale, do so outside of CORE. This further risks proliferating multiple-change-points, complicates traceability and disincentivizes standardized and shared data models. The consequences of a deeply embedded payment system in CORE, can be felt in increased payment remediation costs, lower STP and overall reduced customer experience. Despite the appearance of "**Real-Time**", P2P services like Zelle in US ride on a 3/5 day ACH rail and demand a separate payment flow, often with suboptimal customer experience.



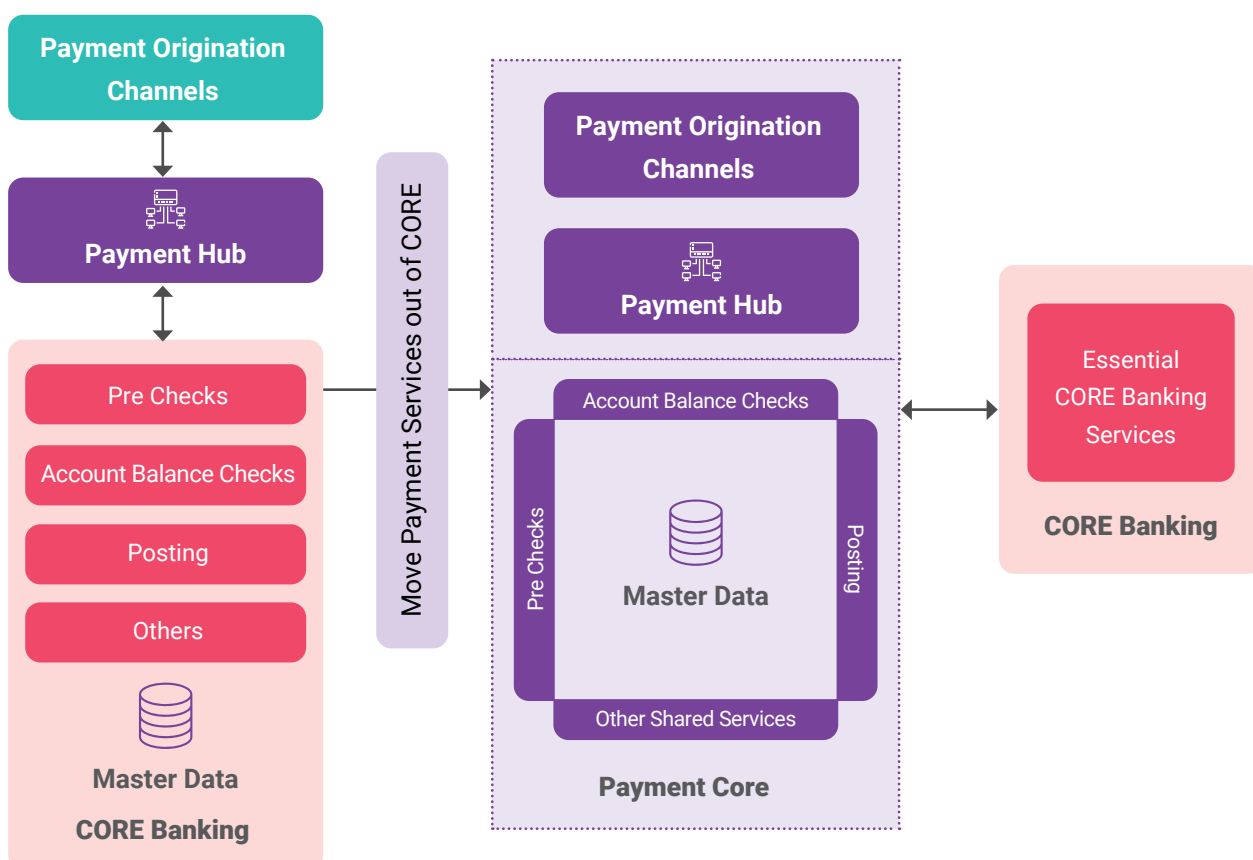


4. Payments Core Strategy

By adopting a **Paas** (Payment as a Service) model, banks can handpick solutions and services that offer best of the breed capabilities. This also helps banks focus on their key competencies and maintains a competitive edge at delivering customer value at speed.

Modern Payment Hubs and PaaS models are already channel agnostic and can almost process a payment end to end, barring a handful of key touch points to CORE, like account check, balance check and postings. With such limited, but extremely key interactions with CORE, a fair argument could be made to move these touch points out of CORE, to cut proverbial umbilical cord, enabling a truly independent, end to end payment hub.

Out of the seven levers in modernizing core banking advocated by McKinsey⁸, reducing complexity by carving out Master Data components is a key lever. By moving master data out of the CORE systems, banks can standardize and share this key data set. While Open Banking has partly enabled this for UK and EU banks, banks in the rest of the world can step in to the future of Open Finance by offering Master Data & Customer Data as shared services, de-coupled from CORE systems.

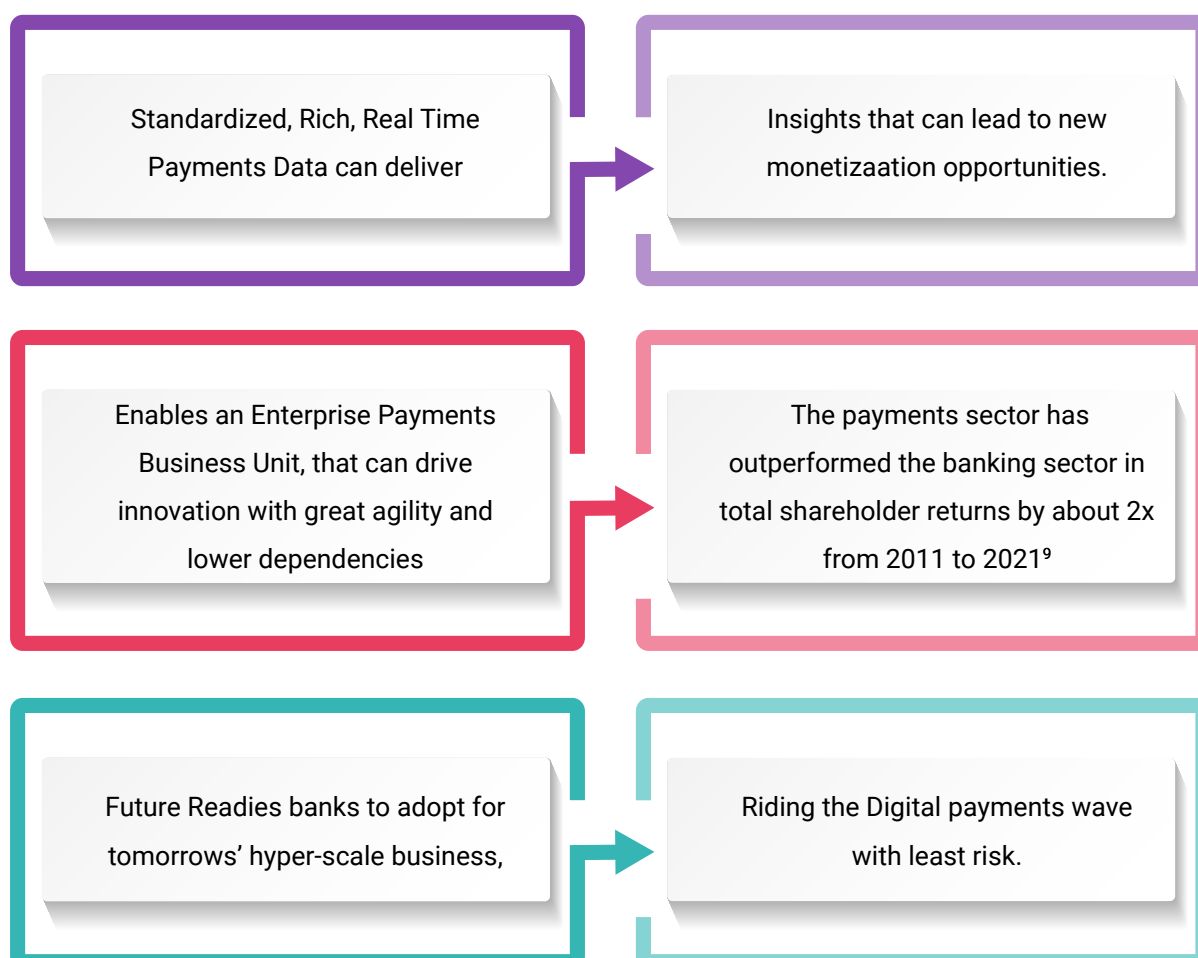




- Move payments touch points out of Core Banking System, into a shared service model.
- Evolve a centralized Payment Processing Platform, that is granular and API enabled.
- Enable a highly agile Payment ecosystem that is freed from slow moving Core System cogs.

By moving payments out of the Core Banking Systems, the payments business will be able to meet industrial volumes at maximum throughput and minimal downtime, thereby enabling banks to offer true breed **24*7** real time payments across segments - consumer, commercial, small business and across geographies. By consolidating and centralizing payments data, informed decision making based on real time metrics is a possibility. This could help banks identify duplicate systems, workloads and flows, further reducing costs, freeing up resources to address mission critical responsibilities.

4.1. Opportunities from Payments Core





5. Conclusion

Having evolved from Payment Engines, Payment Hubs in its current form have been offering far better services and value to customers. However as the global pandemic has shown, business that are adept at changing course with in a limited time, have survived and proliferated, while larger entrenched players with bolted interfaces have been seeing their revenue and market share being eroded. The time and cost associated with change is significant for the incumbents, as system-level change management challenges associated with lock step changes in Payment Hubs and Core Banking systems are still prevalent.

Further, there's a growing trend of promoting non-scheme (Visa, MasterCard etc) payments across geographies e.g New Payment Architecture in UK, UPI in India. As a result of which, transactions volumes and loads on Payment Hubs is expected to increase manifold.

By decoupling the payment interface with the core systems and moving payments out of Core, banks will be able to revitalize their payment portfolio, remove system level bottlenecks, improve processing times and remain at the forefront of innovation. It becomes evident that Payments CORE that is built on the latest technology stack and that is agile to absorb future technologies with minimum disruption will be able to offer a much greater customer experience on an enhanced value proposition.

Sources

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