

Payments Modernization Game Plan: *Moving Forward with Existing Infrastructure*



PaymentSource hosted a [webinar](#) featuring Erika Baumann, Senior Research Analyst for Aite Group, and Mark Ranta, Payments Practice Lead for Alacriti, discussing payments modernization strategy that works with existing structure. Here, we summarize that conversation and provide more on payments modernization.

Faster Payments Landscape

The disjointed nature of services, products, and channels within a financial institution, is a huge pain point. Adding new functionality and innovation is necessary. However, with legacy infrastructure, that has traditionally involved working with various vendors. Having a patchwork of vendors creates a disjointed experience in terms of what accounts are accessible, what fees are being assessed, what products are available across channels, and the look and feel of the experience. As a result, financial institutions have been challenged with how to meet their clients where they want to be met with how they want to pay. How to drive flexibility within the FI's core systems to change those services as new clearing and settlement channels arise is a key concern.

Payments modernization is an umbrella term to cover all initiatives that help to remove manual processes. It could be onboarding; it could be integrated receivables or initiatives that modify a user experience or a new cash management platform. Or it could be new value-added reporting and analytics capabilities to make reporting

more action-based for consumers. This also includes payments because all of this ultimately touches payments. Money movement capabilities with access to emerging payment capabilities are an integral part of payment modernization.

“Although the majority of financial institutions will say that digital or payment transformation is an extremely strong priority, most are just at the tip of the iceberg in making a material difference.”, Baumann explained. “The process that we’re going through right now is to make financial institutions more scalable for the next one to two years, but also for the next twenty to thirty years.”

COVID-19 has accelerated the demand for digitization and automation, raising questions such as: *How do I make my payments more efficient? How do I move away from checks?* Researchers are seeing an increase in volume payments that need to be reassociated. These payments have to be reconciled on the back end, which causes a need to increase the straight through processing rate. Intelligent routing to meet client demands when it comes to their payments functionality becomes more necessary.

For payment capability use cases, push to card (which uses existing debit card rails) is great for business to consumer payments. There has been a big increase in adoption of push to card, and use cases for real-time payments are picking up as well. Early Warning Services has recently [announced](#) a partnership with The Clearing House where financial institutions can now settle Zelle payments over the RTP network. This is popular in the P2P space, while FedNow will be more of an A2A solution. The B2C space is really critical because it’s where market differentiation and loyalty is built. For example, an insurance company paying immediately for an emergency could easily drive differentiation and loyalty. Today’s consumers can more immediately act to change who they do business with.

Real-Time Payments

We’re still at the beginning of the journey of RTP. Many of the financial institutions that are live today with The Clearing House are in receive-only mode. They’re able to receive inbound payments from the big payroll companies like ADP and Paychex, but they’re not quite at the point of being able to send an action upon notifications coming through the network. It’s reasonable then to expect that 2021 will be a big year for RFP (Request for Payment), which is arguably the most powerful RTP messaging type. A biller can send a request to be paid which is acted upon within the originating bank’s system. This is a compelling call to action that can be a very strategic product for electronic invoicing and bill payment, and solves a lot of problems with processes that are still paper-based today (for example, a utility company sending a request for payment). With ACH, that data would most likely come from an email or another channel that requires more steps to pay.

Both businesses and employees benefit greatly from RTP. Employers can provide same day payroll to their employees and not have delays because of payday that fall on holidays. The ability for an SMB to receive a real-time payment can make a huge difference when it comes to liquidity. These are all examples of why it’s important to provide access to better technology.

Real-time payments and more payment choices to appease recipients were already driving payments modernization. But viewing cash as dirty during the pandemic broke an already accelerating trend line and drove digital payments even faster. However, some factors are inhibiting adoption. The industry needs to overcome these factors, such as a need for more education.

Disintermediation

Research shows that [90%](#) of businesses say they prefer some sort of electronic payments. They believe there are different use cases better suited for different payment methods. However, some businesses are not getting access to all these payment types through their financial institutions fast enough. As a result, they are turning to non-bank payment providers. Another issue is the education gap—corporates need to be informed of what their options are to develop an effective payment strategy. With these gaps, businesses of all sizes are going to turn to somewhere where they can get a better education if they're not getting it from their financial institution.

Baumann supported this statement with a statistic. "In the mid and large size business space, of those businesses that place a high priority on improving their payments process, [58%](#) of them say that they would leave their current financial institution or will be leaving their current financial institution to get access to a wider breadth of payment capabilities, including real-time payments."

Disintermediation can happen when businesses feel that fintechs who are actually competing in the banking industry rather than partnering, offer a greater value than traditional financial institutions. Sometimes these financial institutions don't even know that they are being disintermediated. For example, a business might still have operating accounts at a financial institution, but they're using integrated receivables from a vendor, using something separate for their cash flow forecasting, or maybe they're working directly with a payments fintech that is able to provide their clients with access to the functionality that they demand.

Research shows that [36%](#) of small businesses feel fintechs are more likely than financial institutions to offer products they're willing to pay for. Enhancing infrastructure to enable new payment products and technologies with a speed to market that equals or exceeds market opportunity is key so financial institutions are no longer cut out of the picture.

Payment Innovation Challenges

Common payment modernization questions are: *How do I best use the electronic methods available? What are the use cases appropriate for each? How do I incorporate this into a payment strategy?* This is especially true for real-time payments. Businesses are looking to their financial institutions to help fill that education gap. We have an opportunity in the market to learn about fintechs and what they offer. Many financial institutions are dependent on their core providers, and they say they might need to wait or feel they need to wait for their core provider to bring forth innovations. Legacy core systems can bring more complexity—not the least of which is a lot of customization that makes it difficult and risky to make changes.

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Typically, most payments revenue comes from transactional fees at financial institutions. There are also subscription or maintenance fees. However, legacy payment infrastructures are becoming less profitable. According to Baumann, “A lot of financial institutions are saying that their payments business is getting close to hurdles. On many of these relationships, they're having to price so competitively that it is difficult to be able to have the profit margin needed, to be able to keep these relationships where they need to be, to say we can price low but we are still making money on these relationships.”

One opportunity for monetization is data. A hub infrastructure can help normalize data to create new offerings as well as API-based offerings to offer stickier services. That way, it's not just the transaction. It's the value-added analytics services that can be attached to those payments as well. This ensures that real-time payments will be less expensive than other payment methods from implementation. A hub infrastructure helps to streamline processes—all of your systems are working together, and you don't have the added expense of running something completely separate. Volumes move more quickly, and levels of integration with ERP (Enterprise Resource Planning) systems improve. In Aite's corporate research, they have come across banks who have invested significantly in ERP systems. However, they have to keep spreadsheets because there is no integration with the ERP technology.

Lack of education can be a huge barrier to change. For instance, financial institutions have repeatedly told Aite that they do not need integrated receivables. But then, when asked if they needed to increase straight-through processing rates and if they had a pain point of reconciling remittance information with payment, the answer was a resounding yes.

Opportunities

According to Aite, banks continually list retaining clients as a priority, and about [a third](#) of banks have the goal of monetizing data. That number is expected to continue to grow. So a lot is riding on payments transformation and the ability to pick the right partners on the ability to offer faster payments.

Again, a lot of the opportunity is around education. A small business may not know what an ACH file is but they do know that they need to move a certain amount of money and get it to its destination as rapidly as possible because it's going to slow down their production line or slow down their ability to buy the next widget.

Being able to get that payment to the merchant on a Saturday as they close for the weekend so they can pay their employees at that point in time could be a really big value add. There's an opportunity to create new fee revenue opportunities or net new relationship revenue opportunities. Or to look at it on the reverse side, protecting your existing revenue and protecting your clients from dropping off.

Starting Your Faster Payments Journey

Ranta suggests looking at the unique needs of the financial institution consumer base to get started on your faster payments journey. “Every single one of our financial institutions in the U.S. services a slightly different client base with different needs and different things that are important to them—whether you're a commercial bank that's

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only focused on businesses, or if you're a consumer credit union that's focused on the payment needs of a very specific member base such as teachers or firefighters. There are specific needs and use cases that will resonate with them. Look at how they speak about their money movement and what their needs are. I always look at the receive-only persona of real-time payments and say, that's a great place to start because it's the least invasive in terms of your existing infrastructure." Consider what consumers need today and what they will want tomorrow. Are they looking for [unified money movement](#) experiences? For instance, simplifying the consumer payment experience and making it easier so they don't have to try to go out into a separate app (e.g., Paypal or CashApp) and keeping that all into a single unified experience.

The next logical step is evaluating how to get 24x7x365 availability to your institution. It's a change, not only from the availability to push on or out of the account but also how to look at services. Nacha recently [announced](#) that the Same Day ACH Payment limit has been increased to \$1m. It is likely that TCH and [RTP](#) move to the same limit number in the next year or so. Overall, the value of the transactions and the limits for faster payments have been rapidly rising. The U.K. and similar locations went through the same process. They started at a somewhat lower threshold and rapidly moved up.

Starting with receive-only is a soft entry into the faster payments space. One of the most popular use cases for RTP is payroll (e.g., hourly payroll). Financial institutions have to think about how to handle multiple single message type payments, multiple times a day, that are independent of one another vs. the large form batches that we're all accustomed to. These are coming from ERP systems upstream to be able to action upon and make those payments.

The next step is thinking about building out a fintech ecosystem. That doesn't mean replacing every function you have, but including a new layer of interaction that can leverage [APIs](#) for newer technology to be able to translate files and send them into existing infrastructure to execute.

Ranta asserted the importance of faster payments for consumer loyalty. "When we're talking about [disbursements](#), especially insurance claims given the past year, the immediacy and the emotional nature of getting those funds in real-time is a real value add to a consumer. Looking at those as emotional payments and that they're in a moment where you can meet that need and get the funds available in emergencies such as the flooding we saw last year."

Fintech Partnerships

As it becomes more expensive to build everything in-house and necessary to have experts guide implementation and strategy, fintech partnerships have evolved to be more popular. They are also there to answer your questions and provide their expertise.

In the last five years, the relationships between fintechs and financial institutions have evolved. At one point, fintechs were either purely disintermediating institutions or working *with* the largest institutions. However, technology became more accessible. So now, fintechs are able to make technology available to financial institutions regardless of size. This levels the playing field so that even the smallest institutions can compete with super-regional or even global financial institutions. Financial institutions will

build out their own fintech ecosystems. Fintechs are building out API libraries to help financial institutions get quick and easy access to API value-added functionality. That will continue to mature even more as the midsize and smaller financial institutions make these strategic partnerships with financial technology providers.

Conclusion

The Clearing House, the Federal Reserve, Visa Direct, and MasterCard network are all networks with exciting use cases. Each can serve a slightly different function. They all have value, and the key to your payments modernization strategy is to figure out which one to leverage to offer a better experience to your consumer. By working with a fintech partner, you can realize your goals using a strategy that makes the most sense for your financial institution.

To learn more about industry changes and concerns, watch the full webinar, **Payments Modernization Game Plan: Moving Forward with Existing Infrastructure**, featuring Aite Group and Alacriti.



WEBINAR PLAYBACK

Payments Modernization Game Plan: Moving Forward with Existing Infrastructure

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The banner features a man in a light blue shirt and dark tie, smiling and looking at his smartphone while holding a coffee cup. A large white play button icon is overlaid on a dark teal circular background.

Today's legacy and siloed banking technology infrastructure limit financial institutions' ability to rapidly innovate. It's time to look at money movement in a new way. Alacriti's Orbipay Unified Money Movement Services does just that. Whether it's real-time payments, digital disbursements, or bill pay, our cloud-based platform enables banks and credit unions to quickly and seamlessly deliver modern digital payments and money movement experiences. To speak with an Alacriti real-time payments expert, please contact us at (908) 791-2916 or info@alacriti.com