Alacriti

# Payments in 2023: What You Need to Know


2023 will be an important year for payments. With the launch of the FedNow℠ Service, the prevalence of real-time payments continues to accelerate. At the same time, instant payments fraud is receiving a great deal of attention. [ISO 20022]() is also a hot topic as there is a mandatory Fedwire migration to it by 2025 and a current global migration of MT to MX on SWIFT (which also leverages ISO 20022). In an American Banker [webinar](), Gareth Lodge, Senior Analyst, Global Payments at Celent, and Mark Majeske, Senior Vice President, Faster Payments at Alacriti, discussed what U.S. financial institutions have to do to catch up with the rest of the world, and how their approaches to changes will be a competitive differentiator.

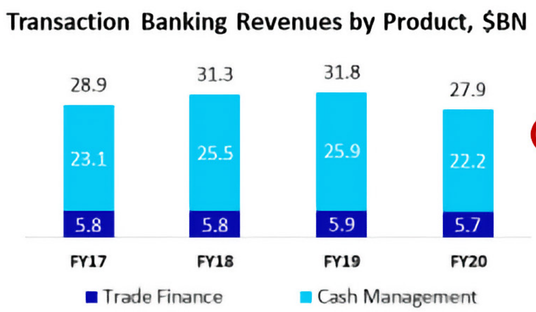
## Economy

Lodge began the webinar by discussing the state of the economy. "From my clients and colleagues, it's a very interesting debate as to whether the economy is doing really well or we're about to go into recession. That's not really at the point of what we're talking about today. We're starting from two perspectives. Where we've come from and what might happen this year—taken together. You need to have an understanding of both of those and hope for the best, but plan for the worst."

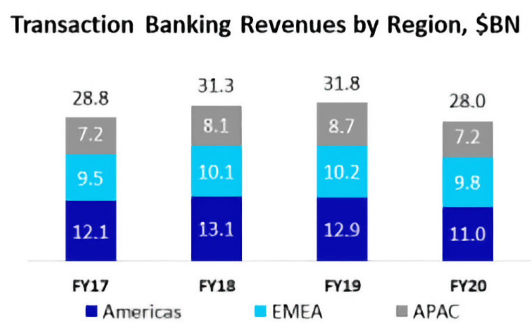
Banking was not excluded from the extreme effects of the pandemic. Statistics from 2020 and early indications for 2021 demonstrated that across the board, revenues were down—a loss of 3-4 years worth of growth. “We saw those impacts despite many of our U.S. clients saying how well they were doing. The results show otherwise. And so a common theme in our discussions was that they need to reduce costs and to find new sources of revenue to get the balance in a better position,” shared Lodge.

## 2020 CAST A LONG SHADOW ON BANKING

In FY 2020, cash management was hardest hit



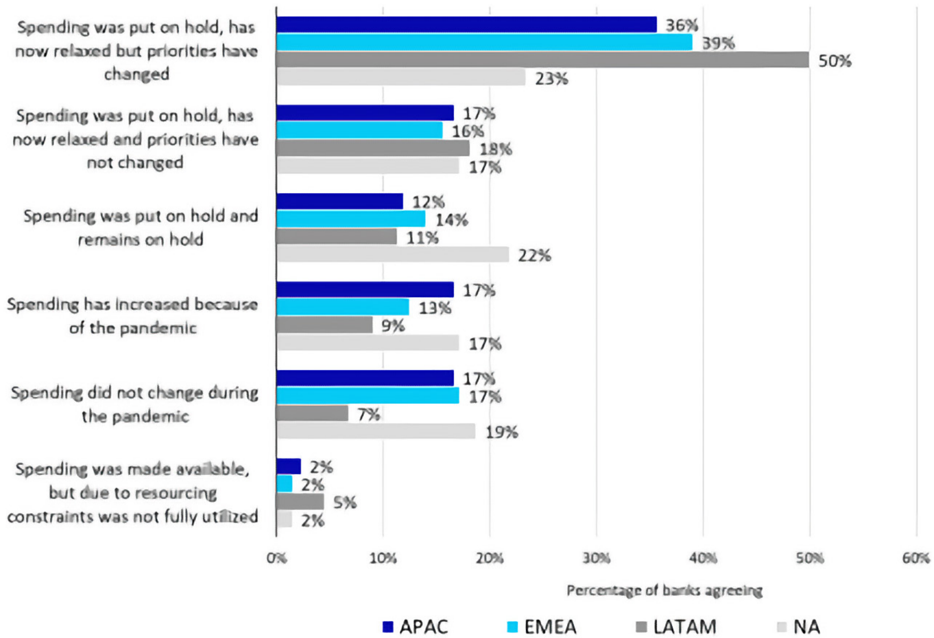

| CAGR | 3 Year | YoY |
|---|---|---|
| Total | 0.1% | -12.3% |
| Cash Mgmt | -0.2% | -14.3% |
| Trade Finance | -0.3% | -3.4% |




| CAGR | 3 Year | YoY |
|---|---|---|
| Global | -0.1% | -11.9% |
| APAC | -0.0% | -17.2% |
| EMEA | -0.3% | 3.9% |
| Americas | -0.9% | -14.7% |

*Source: Coalition TB Index-FY 20, March 2021, Coalition Greenwich*

In 2021, Celent did a large global survey looking at the state of the nation for payments modernization. One of the questions asked to banks was, “What was the impact of the pandemic on your IT spending in payments?” Around 15-18 months into the pandemic, 22% of U.S. banks reported their IT spending was put on hold and remained on hold. Another 23% indicated whilst it was no longer on hold, their priorities had changed. Nearly half of U.S. banks weren't doing the things they had planned to do at the beginning of the pandemic. That created both a backlog of things they needed to do, a change of things they now have to do, and/or with severe pressures on their budgets. This set the theme for much of 2022 to making dollars go further and catch up.




As late as May 2021, 22% of US banks reported IT spending remained on hold, with another 23% seeing their budget priorities changed

Question: "How has COVID-19 impacted your investments in payments technology?"

*Source: Celent "State of the Payments Nation Survey", May 2021*

Lodge had an interesting metaphor for the economy. "We're coming into this year with pressure on our revenue, spending, and many things going on around the world. I would liken it to a game of Jenga. When it's all piled neatly together, it's a pretty stable, sturdy block of wood. But as you start pulling out the individual blocks, whether it is inflation or interest rates, or the war in Ukraine, it starts to get more fragile. As you pull the blocks out, it may not be immediately apparent what the impact is going to be overall. The U.S. is a pretty resilient place and is seeing a strong labor market. The challenge is, though, that's not happening in the global market. The IMF believes that a third of all global economies either are, or will be, in a recession in 2023, and many already are—U.K., Germany, India, and China, just to name a few. And so even if they don't necessarily put the U.S. into a recession, it does have a domino effect. For example, if you've tried to buy a used car over the last year, you will have noticed that the prices have gone up quite significantly. And that's because if you wanted to buy an Audi, Volkswagen, BMW, Mercedes, Nissan, etc., all of their parts were built in Ukraine and/or Germany. And so it may not be immediately apparent, but there are ripple effects."

Changes in payments give a good indication of what's happening in the economy. However, it's important to go beyond face value to understand what's happening. For example, when the economy starts to weaken, discretionary spending is cut (e.g., travel, eating out, big-ticket items like cards, etc.). And there's also typically a move from credit to debit as people start to go into budgeting mode.

At face value, credit card revenue looks like it's falling a little bit at first as the interchange rates fall, but then it seems to increase. This is because of the penalty fees, interest rates, late fees, and other things that will continue to grow as interest rates continue to rise. The same happens with debit cards. They look as if the revenue volumes are increasing, but the reality is the values are starting to fall as people are breaking bigger purchases into much smaller purchases. It's important to be able to spot the early signs of slowing or changing spending. It's also important to identify who can't pay versus who won't pay to see where to put your best collection agencies and how you support customers over the long term. Also, the focus should be on margin—not revenue in payment.

Many banks just look at the headline revenue and how much they've made from fee income. Lodge elaborated, "In reality, there are all sorts of aspects to it. What we've seen in many other countries around the world, for example, is banks actively promoting real-time payments over debit card payments. Because, actually, overall, the margins are typically better. They might not be generating the revenue, but there's a strong correlation between the average balance that a real-time payment user has and the number of payments that they make. Therefore, there's a list in terms of net balance income. It also means that those customers typically go through the bank's website. So you're having more touchpoints with them to support them with other aspects, and you have greater visibility and other benefits that banks believe are a benefit over and above debit card revenue. So it's not just revenue. It's the margin and counting revenue in payments."

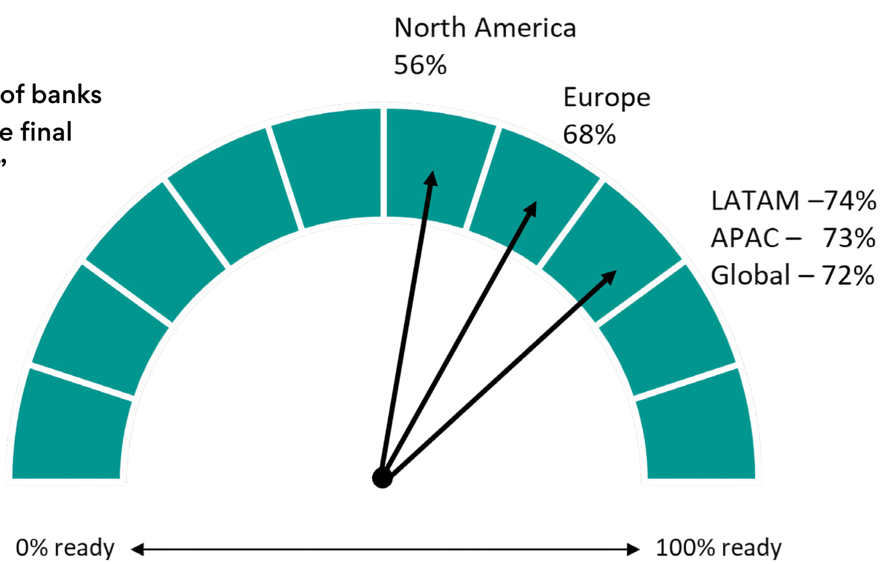
## State of the Nation on ISO 20022

ISO 20022 is the future of financial messaging. However, the U.S. is the last major economy to start to move toward it. In fact, it's been used in Europe, China, and India for over a decade.

Lodge explained, "Yes, it is a cross-border thing because it becomes a lingua franca. You are using the same terminology, the same character set—but that same terminology and characters and dictionary applies across all payments and also all the different parts of the payment value chain. That creates all sorts of benefits not often talked about. First, you can now store any ISO 20022 message in the same data store, whether it's an e-invoice, a card, a wire, ACH, or real-time. For the first time, you'll have a full view of that customer data, and it's a lot easier and quicker to do that analysis. Another benefit is those data stores within an XML store, providing around circa 80% saving in data requirements. That's a massive saving in your licensing costs and your future planning. It's also the extra fields, the extra data in those fields, and the structure of them. Imagine getting an invoice that has all the data about what has been paid and what hasn't been paid because it's in the payment message. It's consumed into your ERP system, and the automated reconciliation takes place. The benefits are massive long term."

One of the biggest migrations taking place currently is SWIFT moving from the MT to MX message—which means moving to ISO 20022. It's been in progress for at least five years. A Celent survey showed that 11,000 banks globally on SWIFT are migrating to ISO 20022. However, despite starting many years ago, many will miss the 2025 deadline. While the global average is 72%, North America is only 56%. So a key question will be, "How will payments get across borders?" Corporations may switch to a bank that can make them because they can't afford to not make and send payments. Over a quarter of the U.S. banks believed that they can adapt internal systems to make this work. However, Lodge asserted that due to the amount of new data, new fields, and new structure that, "There's simply no way you could change every single system that payment uses without some trade indication, some loss, or not even being able to create it in the first place."

**"What proportion of banks will be ready by the final deadline in 2025?"**




**Extrapolating North American Banks estimates globally, over 4,800 banks won't be ready in time**

*Source: Celent Global ISO 20022 Readiness Survey, 2022*

The Fedwire migration to ISO 20022 is coming in 2035. Currently, no installed legacy product is capable of handling this messaging system. None of the legacy products have a simple migration path to them because it is so fundamentally different. There are a limited number of vendors who could do this, yet there are nearly 5,000 banks who need to issue RFI's ,choose a solution provider, and then do testing. That could mean getting your certificate at the last moment. Lodge said, "In reality, it's probably more than two years from today that you need to be going into final testing. So you need to be getting a move on."

Real-time payments rely on ISO 20022 as well. "If you're doing a Fedwire migration, why aren't you looking at the RTP network™ and FedNow in parallel? Because there's a lot of similarity between those two products, with the single messages 24/7. They're also very similar in terms of requirements," said Lodge.

## Factors Driving Instant Payment Decisioning in 2023

Majeske then discussed factors that are driving instant payment decisioning in 2023. "A lot of this information has come through conversations I've had with financial institutions and just an analysis of the market overall. I place these into three categories."

| ECONOMIC | PRODUCT CONSIDERATIONS | POTENTIAL CONSIDERATIONS |
|---|---|---|
| • Will recession pull back or re-allocate 2023 Investment in Instant Payments?<br>• Will FI's choose to utilize Receive Only and address Send Later? Are there economic advantages to doing both?<br>• Are FI's waiting for FedNow in June/July vs. launching RTP now or will they launch both?<br>• What are FIs' monetization expectations? Cost or profit center? | • RTP vs. FedNow vs. Both<br>• Receive Only vs. Send/RFP<br>• Fraud: Based on existing challenges in marketplace<br>• Establishing what FI customers want vs. what FI's plan to deliver<br>• Confusion regarding who and how many vendors to engage in the process.<br>• Estimated time for FedNow adoption to scale up? | • Anticipated level of merger activities among SMB's planned for 2023<br>• FI's hesitant to adopt SEND capabilities due to anticipated fraud.<br>• FI's are currently preoccupied with managing Operations with fewer staff.<br>• Current Regulatory environment re: Fraud Liability |

Majeske continued, "I've been in banking for a while. So we know what happens. We get into a recession, and we reallocate funds to different projects and cancel some projects. And what we want to encourage is that you look at prioritization of those projects and strongly consider instant payments as part of your plan going forward. I think there's enough growth with the excitement of FedNow going live this year that putting it off might make it difficult to catch up. Will financial institutions choose to utilize Receive Only and address Send later? From an economic perspective, yes, it's probably easier, but I would encourage people to look very carefully at it. Because from my experience in the development of the RTP® network, adding Send is not that big of a lift from doing Receive Only from a technology and implementation perspective. There are increased requirements for fraud, but nothing's stopping you from deploying Send and not using it until you're ready. That way, you've gained economies of scale from doing both at the same time and then launching Send when you're ready."

Some financial institutions prefer to enter instant payments via Receive Only. Majeske speculated why. "The reasoning that I'm finding most is that they prefer to enter instant payments slowly to gauge customer acceptance. So they're not quite sure how their customers are going to perceive it. Also, there is a fear of fraud. In addition, they have to be ready to accommodate Send operationally. However, I think you'll be surprised at what the systems already have built-in. And we will do most of the heavy lifting for you."

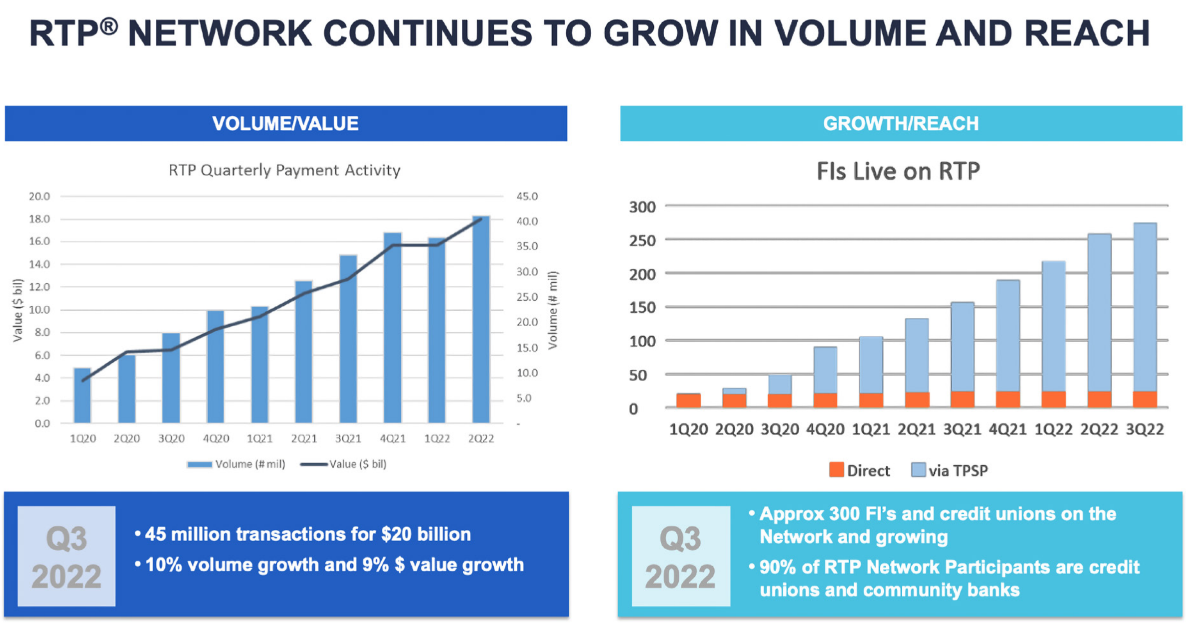
Majeske brought up the topic of fraud for instant payments. Fraud has to be considered when implementing Send. "Start looking at your fraud systems and what they can and cannot do, and get an idea of what would need to be done in the instant payments area to protect you and your customers. Both the RTP network and the FedNow Service are extremely well designed to lead us not only into 2023 but into the future. I suggest starting with your customer base and what they need. Financial institutions are currently preoccupied with managing operations with fewer staff. Alacriti tries to make sure that we don't burden your operational team with adding new rails. Another thing to look at is the current regulatory environment for fraud liability. There's a lot of discussion around the assignment of liability for fraudulent payments."

Majeske gave a brief overview of Alacriti's new fraud offering, which is through a partnership with Socure. "We realized that many small to medium-sized institutions have enterprise systems that are not built for real-time—they're built for ACH and Wire. This is a system that has proactive, real-time fraud protection 24/7, with automated decisioning via our partnership. The solution scores and analyzes transactions before they occur to reduce fraud. It's customizable, so financial institutions can adjust tolerance levels based on their individual needs. Alacriti's fraud solution augments (rather than replaces) existing fraud systems. The data is shared between the two systems, making each one stronger."

## RTP Network 2023 Initiatives

The Clearing House continues to work on cross-border payments and has a cross-border pilot involving European banks. They're testing with about ten banks. ISO 20022 will be extremely important in communicating with other countries are using it. A broader reach of RfP-based use cases in 2023 is expected, including bill pay. Lastly, RTP 3.0 will include enhanced data elements in messaging, funding, agent migration, and architectural changes for performance enhancement.

Majeske shared the latest metrics from The Clearing House. As of Q3 2022, they have had 45 million transactions for $20 billion, a 10% volume growth, and a 9% value growth in that time period. The chart below on the left-hand side shows a growth in transactions. “Generally, when you show a steady increase in value, there are people using the system repetitively, and they feel a lot more confident about the system that it works, and they feel more comfortable sending more funds through the system. On the right-hand side from Q3, approximately 300 FIs are on the network currently. The orange bars show FIs going directly to The Clearing House, and that's pretty much leveled off. Where you see the light blue is where banks and credit unions are using TPSPs. The interesting fact is that 90% of RTP network participants are credit unions and community banks. So,t hey play a heavy role in building out that network, and it'll be important for FedNow as well.”




*Source: The Clearing House*

Additional use cases are imperative to the growth of instant payments. Customers, businesses, and consumers respond to payment applications, not payment rails. That is a key focus for growth. Current high-volume use cases include:

- Wallet disbursement and funding (e.g., Venmo, PayPal, sports wagering apps, etc.)
- P2P – Zelle™
- Payroll
- Earned Wage Access

## The Future of FedNow

Majeske shared some interesting data from the Federal Reserve. They found that 9 in 10 businesses expect to make and receive faster payments within three years, which helps to demonstrate that the market is ready for instant payments. It's commonly asked how long it will take for FedNow to be ubiquitous. Five years after its launch, the RTP network is at 65% ubiquity. However, when first launched, the market had to be educated along with the introduction of the network. This cost a lot of time. Since the concept of instant payments is more commonly known, Majeske predicted that the ubiquity of the FedNow Service will probably take less time as a result.

## Moving Forward

Whether to use the RTP network, FedNow or both, is really a decision unique to the financial institution. "I think it links back to who do your clients send payments to and who did they get them from, and which networks are they in. There's no point connecting to a network if you can't reach anybody. Now, FedNow isn't yet live, so RTP is an easier sell because there are people where you can reach straight away. And with many of the solutions in the marketplace, you can be up and running in a matter of weeks and getting the value. So I think it's not so much which one you do first because that's quite obvious at the moment because you can only do one first and go live. But longer term, I think it becomes more of a tactical decision," Lodge shared. Majeske provided his input as well, "I would say look at your economies of scale in terms of bringing both on. I know a lot of larger banks are bringing both on because they know that there's going to be volume for each, and they have to be part of it."

As for using Receive Only or also doing Send, Lodge provided his opinion "I think in a very simplistic way, you're missing out on half the value, and you are not necessarily getting that full value. Who are your customers going to send to? Who are they going to receive from? Typically that starts to show what kind of transactions they could be replacing or what value they could get. And then it's pretty clear to most organizations you need to be able to Send and Receive.

*To find out more about what's expected in payments in 2023, watch the full webinar, **Payments in 2023: What You Need to Know**, featuring Celent and Alacriti.*


*Alacriti's centralized payment platform, Cosmos Payments, provides innovation opportunities and the ability for customers to make smart routing decisions at the financial institution to meet their individual needs. Financial institutions can unify payment processing all in one cloud-based platform—ACH, the Fedwire Funds Service, TCH RTP® network, Visa Direct, and soon, the FedNow℠ Service. To speak with an Alacriti payments expert, please contact us at (908) 791-2916 or info@alacriti.com*