FINEXTRA’S EUROPEAN PAYMENTS INDUSTRY INSIGHTS REPORT
JUNE 2017

MASTERING TODAY’S CHALLENGES: HARNESING TOMORROW’S OPPORTUNITIES
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Europe’s payments landscape is being transformed by regulation, advances in technology and the evolving demands of retail and corporate customers.

In response to unprecedented levels of change, European banks and payment service providers (PSPs) are reinventing their business and technology strategies – formulating new operating models, evaluating new technologies, and redesigning customer journeys to stay competitive in a fast-evolving landscape.

At this critical time, Finextra’s European Payments Industry Insights Report explores the challenges and opportunities for banks in the current environment. The report brings together the viewpoints of a wide range of leading payments industry experts with the findings of Finextra’s own market research during 2017 – to generate insights into the banks’ options for a future being reshaped by a series of powerful change drivers.
DO BANKS KNOW WHAT THEIR FUTURE MODELS SHOULD BE?

As Becky Clements, Head of Industry Engagement and Payment Change at Metro Bank, says, on the retail side, “customers don’t care about payments”. “They want to be able to buy things. As payments become more digital and there is less use of cash, customers want payments to be simple, easy, seamless, safe and secure. They don’t really care what operations are going on in the background – but they do expect it all to go right, which is why we can never forget the need for security, reliability and resilience,” she adds.

On the corporate side, the impact of ‘consumerisation’ is driving the need for innovation, suggests Daniel Szmukler, Director, Euro Banking Association (EBA). “Much of the innovation in the retail side of payments is not possible on the corporate side but corporate treasurers are consumers too and they want real-time liquidity updates on their mobiles. Banks will need to be prepared to deal with these requirements – and this segment may be captive now but it’s fickle and will switch for better services,” he says.

In addition, certain types of corporates care very much about payments, as Jeremy Light, Managing Director of Accenture Payment Services in EMEA, points out. “Merchants are waking up to what the revised Payment Services Directive (PSD2) could mean for them, and they are looking at how to create a business case to do what they want to do around the omnichannel experience. Payments are integral to that – and a real pain,” he says.

“Card payments work well for either in-store or online transactions – but it rare for a retailer to have processes designed for multiple channels together. So where an aspect of the transaction – a refund and return say, which mingles an online payment with a visit to a store for refund – existing processes with cards typically do not work well.”

By contrast, retailers want an omnichannel strategy, and getting the customer experience right will be essential to that, Light believes. “They don’t particularly like card fees and they have typically had other priorities to tackle, but opportunities now to reduce or avoid these fees by moving
away from cards give retailers a hard business case where cost reduction can fund new capabilities to improve omnichannel processes and the customer experience,” he says.

Carlos Sanchez, CEO and Founder, ipagoo, agrees. “One of the main impacts of PSD2 will be the decrease in the card payments industry, which looks like it will be even faster than initially expected,” he says. “Merchants see huge advantages in not having to rely on cards. For merchants, it’s a high cost, and a separation of payments from cash management which doesn’t make sense.

“Think about the example of the Spanish headquartered retailer Zara. If a French cardholder goes to Sweden and buys something from Zara, the payment has to reach Spain, the information about it will arrive separately, and there will have to be a reconciliation. It could take a month before the payment is settled for Zara. That is the way payments work today.”

By contrast under PSD2 and with instant payments in Europe, account to account payments, which can be reconciled transaction by transaction, become possible, Sanchez continues. “The reduction in time is so significant and this is driving a strong desire to move away from cards to realise profound cost and cash management benefits.”

In terms of how this impacts banks, there is a threat, says Light. “Payment APIs will cannibalise card revenues, especially debit cards, so that’s a risk for banks,” he suggests. “There is not a lot they can do about it unless they get on the front foot with compelling propositions such as recurring payment APIs. One bank we are working with has identified 80 different APIs in such areas as credit checks and point of sale loans, and is intent on monetising them in the medium term to generate new revenue streams.”
THINKING BEYOND REAL-TIME

By Barry Kislingbury, Director,
Solution Consulting, Immediate Payments,
ACI Worldwide

In the run-up to the highly anticipated go-lives of instant payment schemes in Europe and the US later in 2017, it’s easy to forget that – in many markets and for many banks – real-time is very much business as usual.

Faster Payments in the UK for example has already notched up almost a decade of operation. And even aside from the UK – a poster child internationally for advances in instant – there are other markets, like Singapore and Sweden, where real-time is already well-established.

Without playing down for a moment the work that banks impacted by forthcoming schemes need to do to be ready, from both business and technology perspectives, it is important to keep in mind that a scheme going live is only the first step.

Connecting up to new real-time rails and getting internal systems and processes up to speed are essentially table stakes – with the smart, strategic thinking already focused on how banks’ real-time capabilities need to evolve into the future.

The lessons to be learned from markets that are already ahead in real-time, and those banks with the foresight to think beyond the immediate impact of instant payments, include the understanding that the moves to real-time, the revised Payment Services Directive (PSD2) and open banking, digital identity and the General Data Protection Regulation (GDPR) all require technology investment, much of which is similar – and all feed into an emerging bigger picture underpinned by a new approach to payments infrastructure.

A key strand of this thinking is that there are powerful efficiencies to be unlocked by moving additional traffic into the real-time environment. This is not to say that every payment will become an instant payment of course. But while it is not possible to process a real-time payment in a batch environment, it is perfectly possible to process a batch payment in a real-time environment.
Everything can be processed on a real-time platform; real-time is the lowest common denominator and if you want to process a delayed payment in a real-time environment, you certainly can.

This prospect opens up a wider business case for investment in real-time, bringing into scope legacy systems – some of which are decades old, but continue to run and are therefore difficult for banks to turn off.

We are already seeing evidence of banks taking this approach. Some of the RFPs we have received in relation to upcoming real-time schemes have gone far beyond the requirement to connect to a new ACH. They have included – alongside very demanding performance and latency requirements – elements such as real-time hubs, which make it clear that these banks are thinking beyond simply getting instant payments up and running, and have very strong intentions to migrate batch traffic over as well. Creating a real-time hub provides a platform for which to migrate other back office activities at a future time.

Indeed, we’ve heard of some banks that, having formulated the view that real-time is the new normal, plan to turn off their SEPA batch processing systems within five years.

Part of their motive is no doubt to generate significant efficiencies by phasing out old, expensive payments infrastructure. But beyond that, instant payments is a catalyst for a rethink, a lever to think about modernisation. The difficulty of building real-time capabilities on legacy platforms is well known, and even where banks have relatively recently put in place systems enhancements to handle SEPA, these may struggle to cope with the demands of 24/7/365 availability. SEPA hubs didn’t have to be always on, so many are dependent on overnight downtime processing.

As a consequence, the move to instant is an opportunity to put in place a modern platform that not only can cope with the performance and availability requirements of real-time, but also offers the agility needed for banks to quickly respond to the opportunity to provide new products and services in a PSD2 world.

Modern solutions that enable hot deployment with zero downtime – so that when new products are implemented there is no need to take anything down – enable the entirely real-time environment required to effectively expose services to and partner with innovative fintechs, onboard new payment options rapidly and roll out new products in time to capitalise on opportunities as they arise.
This is essential for banks that want to keep up with the pace of change – and we know that this will only increase. We could quite feasibly see cross-border real-time payments within a couple of years, for example, and history tells us that banks that are not first movers cannot necessarily catch up in time to prevent the loss of market opportunity and irreversible business damage.

There could be an important lesson in the approach being taken by some of the ACHs, which are saying that they will charge the same for real-time payments as for standard SEPA payments. This means they are viewing real-time as a loss leader, a chance to poach volumes from their competitors by taking first-mover advantage, and worrying about ultimate revenues later on.

Agility will also underpin banks’ ability to leverage the power of instant to target new revenue opportunities – even new customer segments. Some recent surveys have shown for example that there could be a strong latent demand among small and medium enterprises (SMEs) for real-time based services. Survey findings show that 90% of SMEs in Italy would switch banks to get access to real-time payments and 56% of SMEs in Germany say real-time is essential for the success of their business.

A famously underserved customer segment, SMEs might well pay more for a package of solutions that integrated real-time payments and extra data services into cloud-based accounting platforms – creating a lucrative new niche from which banks could generate additional revenues.

There are two routes to fitting systems for real-time and beyond – the tactical and the strategic. A lot of banks will probably make tactical decisions in the coming months in order to be ready for the go-live of the major new schemes. Others will opt to be more strategic and go live later with a better platform that will give them a strong foundation for modernisation.

It is probable that banks taking a tactical approach will be back to the drawing board very soon, because they can’t achieve the agility they need using old technology.

It can be helpful to think about how rapidly the smartphone landscape has developed during the past two years. If a bank’s systems can’t support real-time, any-to-any connectivity and open APIs, then where does that bank think it will be in five years? At best, it’s on the back foot – at worst, a far more negative picture.

Therefore, if, despite the immediate pressures they face, banks can manage to think ahead, then the wisdom of using real-time as an opportunity to kick off a modernisation programme will be crystal clear.
Survival in the changing landscape means focusing on the value-add, believes Jonathan Williams, Principal Consultant, Mk2 Consulting. “Over the past 5-10 years a new model of payments has emerged – and banks have fought this – where the focus has to be on the added value,” he says. “If you want a payments business as a bank in the future, where you must play is in the value added space.”

For example, he continues, for SMEs, price is not the most important criterion. “The most important element is tracking, so that the payer and the payee know when the payment will happen. This requires remittance information, and payments systems that are geared up for transferring a lot of data. Right now, the payments industry is not really helping SMEs with remittances, and the risk for the payments industry is that it ends up just transferring the value, when in fact it’s all about the data. Every payment has a purpose,” Williams says.

The power of personalisation

Personalising, tailoring and contextualising services in the digital age are certainly on the agenda of banks, with leveraging trust, achieving an omnichannel experience and delivering value even beyond selling products all strongly on their minds, according to the findings of Finextra research from late 2016/early 2017.

### TO WHAT EXTENT IS YOUR BANK’S APPROACH TO PERSONALISING THE SERVICES YOU PROVIDE TO CUSTOMERS DRIVEN BY THESE GOALS?

<table>
<thead>
<tr>
<th>Approach</th>
<th>Not included in our approach</th>
<th>In our future thinking</th>
<th>Not on our radar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positioning ourselves as a trusted partner to each customer, based on understanding their needs and priorities, and advocating on their behalf wherever possible</td>
<td>15%</td>
<td>75%</td>
<td>10%</td>
</tr>
<tr>
<td>Communicating with our customers via the channels they want at the time they want them</td>
<td>1%</td>
<td>99%</td>
<td>0%</td>
</tr>
<tr>
<td>Providing tailored offers for new products and services to our customers when they engage with us</td>
<td>1%</td>
<td>99%</td>
<td>0%</td>
</tr>
<tr>
<td>Finding ways to engage with and add value to our customers even when we are not selling to them or fixing something that has gone wrong</td>
<td>1%</td>
<td>99%</td>
<td>0%</td>
</tr>
<tr>
<td>Putting the customer first to such an extent that we may lose revenue and reduce profitability</td>
<td>10%</td>
<td>85%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Engaging the unengaged customer, a research paper from Finextra in association with SAP Hybris, issued in March 2017.
PSD2: a double-edged sword for corporate banks?

The potential to leverage PSD2 not just to deliver better services to retail customers but also to corporates is clearly being understood by banks, but in tandem they recognise that the work involved to do this is substantial, as demonstrated by the findings of a Finextra survey earlier this year.

**PLEASE INDICATE THE DEGREE TO WHICH YOU AGREE WITH THE FOLLOWING SENTENCES.**

<table>
<thead>
<tr>
<th>Statement</th>
<th>Totally disagree</th>
<th>Partially disagree</th>
<th>Somewhat agree</th>
<th>Totally agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>For corporate banks, PSD2 is a huge opportunity to open up and win new business.</td>
<td>9%</td>
<td>13%</td>
<td>40%</td>
<td>38%</td>
</tr>
<tr>
<td>For corporate banks, PSD2 is a big drain on resources, cost and compliance efforts.</td>
<td>17%</td>
<td>22%</td>
<td>42%</td>
<td>19%</td>
</tr>
</tbody>
</table>

Source: Transaction banking in an open, connected world, a research paper produced by Finextra in association with Misys.

“The payments industry needs to focus not just on the bit it does well already – the reliability and the resilience – but on the data as well,” he adds. “Overall if the payments industry doesn’t wake up to the fact that it’s the data that is more important, then it risks becoming irrelevant.”

Focusing on the data also has the benefit of helping banks tackle financial crime, says Williams. “This is where the financial criminals are trying to get in. They can’t get into the transfer of value so they get into the data, they change the destination, they persuade people to route payments to them.”

A related area in which banks can demonstrate value-add is identity and KYC, suggests Kevin Brown, Senior Advisor, Global Payments. “It’s becoming increasingly clear that a technology solution is needed to maintain KYC and identity on a number of different levels and that will build into what we see going forward. In addition, solutions will emerge for data and how it’s used and controlled especially under PSD2,” he says. “With identity, there is certainly a role for governments to help drive minimum standards and ensure minimum availability for everyone to use, but beyond basic services there is...
also a need for higher level services. Here banks – and others – could play a role providing more sophisticated levels of information, for which companies and individuals could be prepared to pay.”

Finding the value-add is critical, agrees Szmukler. “The payments business is an enabler. It may not be the most glamorous or sexy or profitable, but it’s a constant contributor to P&L and banks need to give it the right prominence, and make payments a business again,” he says. “What I see as the payments business is the value-added element. Payments are part of a lot of transactions. In the Uber example, the pain of the payment has been eliminated. You still have to pay for your taxi ride but you now disassociate the ride from the payment. The payment process is never pleasurable. To innovate, to make it sexy, the best thing banks can do is make it invisible.

“When we think about payments the biggest mistake we make is to treat them as products. The payments business must move beyond the payment, to focus on context and insights into customer behaviour. Payments are about data insights; they are not a product line.”

Payments are also always “an element of something else”, says Brown – and this is where the frictionless nature of payments is becoming so vital. “The transaction is buying the car. The payment, insurance and taxing are all elements alongside that that must happen and that customers want to happen seamlessly but in a controlled way authorised by them. There will be much more focus on the end-to-end transaction rather than the payments part in the middle: customers will just expect that to happen quickly, seamlessly and securely,” he suggests.

This focus on the end-to-end will have the result of extending the payments function, believes Anna Puigoriol, Manager, Payments and Consumer Financing, Sabadell. “Right now we are very focused on the moment of payment, but that payment will expand, and there will be many more opportunities to offer different ways to pay and to integrate payments more with personal finance and lending. These are separate areas today that will be integrated in the future,” she says.
Sanchez agrees that “going forward, the value of being the custodian of the money before and after the payment will have much more value than the payment itself”. “The attack on payments has been so aggressive that it’s now a race to the bottom in terms of time and cost. The realisation of this is reflected in moves like that of Transferwise to offer accounts in addition to money transfers. Swift’s GPI initiative – guaranteeing payments within 24 hours with full traceability and low cost – will enable any bank in the world to do better than Transferwise just by being a part of it, as the largest banks in the world are.”

The degree to which banks understand the imperative to change and find future business models that work depends on which countries they are in, Sanchez believes. “There are two types of markets – those like the UK, France and Spain where the market is highly concentrated on a few large transaction bank monopolies, and those like Italy and Germany which are very fragmented and where banks are used to competing more fiercely for their business. Some of the strategies we are seeing of banks retrenching from other markets in Europe are very short-sighted. Banks should be expanding into Europe, not retreating from it,” he contends.

“
The payments industry needs to focus not just on the bit it does well already — the reliability and the resilience — but on the data as well. Overall if the payments industry doesn’t wake up to the fact that it’s the data that is more important, then it risks becoming irrelevant.”

Jonathan Williams, Principal Consultant, MK2 Consulting
Banks are well used to being required by regulators to do things differently – especially since the influx of post-crisis regulation began. But the forthcoming revised Payment Services Directive (PSD2) goes further. PSD2 requires banks to fundamentally change their business models.

This is a different sort of challenge for banks – facing regulation that interferes with the basic ways in which they do business while allowing lighter regulated competitors to make use of their services and their customers’ data – and one that through our discussions with our clients involves strategic thinking as well as tactical implementation.

To understand the range of responses we are seeing so far, it is useful to think of a ladder, with banks that have decided to do just what they need to comply at the bottom end and at the top end banks that are set on reinventing their business models – and are either already putting a toe in the water or diving right in to the brave new world.

Between those extremes the vast majority of banks are bunched in the middle, unsure whether to climb up or down, undecided on what changes to implement, or how they will make money in the post-PSD2 environment.

These challenges are compounded by the size and market position of the bank. The large, typically pan-European players – those we might call the usual suspects – are wrestling with implementing changes across all their operations in the impacted markets, grappling with implementing the technology they need to achieve and go beyond compliance, while working out how to make their strategies (typically to dive right in) work in practice. How do they actually implement new business models in the areas where they’re focusing, be that cards, consumer services or corporate business?
For some, there is a huge business opportunity in becoming giant 24x7 processors for the industry. But this strategy won’t work for all. If the big banking groups have one type of problem, then domestic-only banks have another. In many markets there are existing domestic processors for cards and ACH payments, often owned originally, and in some cases still part-owned, by those banks. Of course these processors are looking at PSD2 and creating common platforms for domestic and local banks to leverage. The question for local banks then is, do they go with that option, look at a non-domestic platform or strike out on their own? If the domestic platform aligns with the lowest common denominator (rather than the highest common factor), how on earth will domestic banks relying on it ever steal a march and jump ahead of the competition?

The situation could be worse still for the banks which operate across just a couple of countries, or are minor subsidiaries of bigger players. For them the strategic challenge facing all banks right now could be even tougher to navigate. What approach should be taken – adopt their group strategy or keep domestic? How will they compete with the niche players or the larger cross-border, volume-based banks? How will they make money going forward – and how will they make a reality of the elusive concept of ‘value-added services’?

This is a tough problem and like most tough problems it has no easy answer. There is certainly no one-size-fits-all solution. A great deal depends on the decisions banks make about the clients they want to serve. Banks need to ask a number of questions. Do they think the GAFAs will steal their clients? Do they think new fintechs will gain customer trust? Do they foresee their customers being wooed by banks from other countries as domestic boundaries within the Eurozone break down? Do they believe corporate customers will jump to new providers for better services and terms?

Not every bank can follow the same model as the market leaders diving in with new strategies, and in the end even those that do may lose customers in the process. Given customer mobility, could it be better for banks to focus on entirely different segments? For some in the retail business now, could the small business market prove safer and more lucrative instead?

Once they have answered the customer question, banks need to look at the service question. Here as well, it’s easy to talk about value-added services, and much harder to develop use cases that will either make or save money.

The good news is that there are some clear pointers for banks to follow. The first is that payments are intrinsic and inextricably bound to digitalisation, and can be the banks’ secret weapon to stay relevant. The move in the Eurozone to SEPA Instant Credit may be the saviour. Combining instant
payments with open banking and ensuring the right touch, in the right place, at the right time for the chosen customer segment will be paramount.

Beyond that, the only way for banks to progress sensibly with tackling the major strategic challenges they face in the new world is to be realistic about the changes taking place and the position of their existing business in the landscape relative to their customers and their competitors, and to ask very seriously how they can reinvent their business models to remain relevant in the future.

It’s a strategic journey, and banks need to work out where they want that journey to take them. They need to create a roadmap from A to B – while being realistic about A and understanding the competition to get to B.

“Not every bank can follow the same model as the market leaders diving in with new strategies, and in the end even those that do may lose customers in the process. Given customer mobility, could it be better for banks to focus on entirely different segments? For some in the retail business now, could the small business market prove safer and more lucrative instead?”
WILL THE CHANGES UNDER WAY IN PAYMENTS FINALLY SPELL THE END OF LEGACY?

There can be little doubt about the profound technology impacts of PSD2 and instant payments for Europe’s banks. As Leo Lipis, Founder of Lipis Advisors, says: “Developments such as real-time payments and open APIs will certainly put pressures on banks’ IT systems in ways they haven’t felt in the past. Whether an individual bank has the systems in place to do it is hard to say – it depends on when they last went through a major IT renovation – but no doubt as an industry banks will have some trouble coping with these developments.”

Legacy is of course at the route of this problem, and as well as making it difficult for banks to respond to change, it also causes other, very visible challenges, as Jeremy Light, Managing Director of Accenture Payment Services in EMEA, points out. “Operational resilience is a major challenge, with any system outages – even for a few minutes – highly noticeable. Resiliency and robustness are difficult, especially as transaction volumes grow, when you are working with a spaghetti network of old systems and new channels.”

Indeed, guarding robustness is a responsibility banks must always consider when thinking about innovation in payments, as Becky Clements, Head of Industry Engagement and Payments Change at Metro Bank, points out. “Sometimes it might feel like we should be innovating and developing faster, but we have to be safe and resilient and that makes it difficult to make too many changes in one go,” she says.

Legacy is also a weakness that fintech new entrants have targeted – on the grounds that legacy payment platforms do not meet the needs of modern businesses. Danny Aranda, Managing Director, Europe, at Ripple, says: “Global transactional demands are changing, and the current system is woefully inadequate to meet tomorrow’s needs and opportunities when it comes to cross-border payments. Companies are increasingly global from day one and provide on-demand delivery of services. As a result, today’s online-based companies have very complex global supply chains, and need to move money increasingly quickly from, say, their supplier in China (in renminbi)
to a distributor in Germany (in euros), though they are based in the US and transact in US dollars. These kinds of transactions are very different and require a different kind of global payments infrastructure than exists today.”

The urgent requirement to reinvent payments infrastructure is what will drive the next wave of fintech innovation, Aranda believes. “There is a clear need for greater agility in the back office, and that is what we are really excited about in the fintech landscape going forward,” he says. “So much of the innovation has been in the application layer – new models at the front end, running on legacy infrastructure at the back end. Those innovations have gone a long way to improving the customer experience and have resulted in the creation of some excellent products. However, there are limits to the innovation you can introduce at the front end unless you change the infrastructure.”

Banks’ growing commitment to the idea of modernisation is becoming evident, Aranda adds. “Nowadays, we are seeing banks expressing an interest in modernising their payment infrastructures – and this is the first step in taking action which will transform their businesses.”

Whether modernisation can put an end for good to the challenge of legacy is a moot point, however. For Lipis, “the idea that modern technology will somehow bring an end to the need to ever transform payments systems again doesn’t hold water”. “We are never at the end of modernisation. The next new idea will always obviate the technologies in place – and that next big thing is always just over the horizon,” he adds.

Certainly complexity will be hard to avoid, suggests Light. “There will always be a patchwork element to banks’ payments infrastructures. Even for challenger banks starting with a clean sheet of paper and deploying cloud solutions, as their volumes grow, as their customer bases grow, so the complexity of their systems will grow,” he says.

Carlos Sanchez, CEO and Founder of ipagoo, agrees that newness is not a protection against being trapped by legacy technology. “Unless you have built your technology for a specific business model, it’s not plasticine: it’s very difficult to just change your technology – especially when you are serving millions of customers,” he says.

Although the way banks develop systems will change, that will not necessarily reduce complexity, Light adds. “Massive multi-year programmes will become far less common and we will see many more agile, smaller programmes and projects – but that is when complexity creeps in, unless every change, every incremental project is designed and implemented within the context of a structured systems architecture.”
While “technology is certainly more flexible now than it was”, “there are always changes – new business models, regulatory requirements, changes in customer behaviour – and that is why agility is so important, because it is not possible to predict how things will turn out”, he continues.

However difficult the journey from legacy to agility may be for banks, it is a necessary journey, suggests Erkki Poutiainen, Strategy Manager, CM Customer Solutions, Nordea. “In the face of the uncertainty in the market, one wise step for banks to take is to control our cost bases and create agility – platforms that can respond to change quickly and at reasonable cost. This isn’t easy given the legacy in place at most banks, but the more efficient we can be, the less damaging change will be to our business models,” he says.

While legacy is a reality for most banks, today’s technology does offer a viable route away, believes Kevin Brown, Senior Advisor, Global Payments.

“If you are starting from a clean sheet, for example challenger banks, then you have the ability to look at new technology and what it can deliver to your organisation,” he says. “More often, we are seeing traditional banks looking at how they can work with old technology and new, and plot a path to move from one to the other with a risk profile they are comfortable with.”

What is needed, Brown adds, is “not a big bang but a roadmap and some principles, to enable the creation of early agility around the edge followed by agility in the core later, as it becomes possible to replace bigger elements”. In this vein it is interesting, he suggests, to look at the position of central banks on the blockchain question. “Several central banks have said it is too early to move to distributed ledger technology right now, but that if – in five years from now – the technology does come into play, because of this roadmap approach, there is flexibility to incorporate it later.”

There are “clearer” technology options now than there were even five years ago, Brown continues. “Cloud has become much more flexible and is seen as much more secure and applicable as a technology. There are lots of opportunities to use this technology alongside existing infrastructure to create that all important flexibility.”

Leveraging new technology is a way both to tackle legacy – and to unlock the potential of new products and services, suggests Daniel Szmukler, Director, Euro Banking Association (EBA). “Today customer data can be held in 100 plus bank-internal, siloed systems each taking a long time to search to create the degree of granularity needed to do open banking properly. It’s sitting in different parts of the bank, but all of that data is describing who the customer is. To have intelligent insights on the customer, banks need to tap responsibly into that data – and this is where predictive analytics, AI and robotics are coming in,” he says.
Understanding customers is just as critical as deploying technology, of course, as Poutiainen says. “A payment is not a means in itself: it exists to do something else, to activate something else, and it is linked to many other functions in a corporate customer’s business. You have over time planned and implemented processes to meet your efficiency goals. If you receive 50,000 transactions a day, how do you deal with them all? These questions are crucial to the processes of our customers, and if we do not see payments as a core component of our services, but also as a key/trigger to other relevant financial and supply chain services, we miss a major opportunity to help our customers,” he explains.

“There is room for technologies such as robotics and artificial intelligence to help us do this more effectively, but there is room also for just intelligence – based on us taking the time and trouble to find out what our customers need,” he adds.

Brown agrees that “banks need to talk to their corporates – their higher value payments customers – and the digital people within those corporates, in addition to the treasurers”.

“They need to build relationships with whoever is creating the digital strategy for the corporate, because support here is one of the elements corporates are likely to value,” he says.

“In the face of the uncertainty in the market, one wise step for banks to take is to control our cost bases and create agility — platforms that can respond to change quickly and at reasonable cost. This isn’t easy given the legacy in place at most banks, but the more efficient we can be, the less damaging change will be to our business models.”

ERKKI POUTIAINEN, STRATEGY MANAGER, CM CUSTOMER SOLUTIONS, NORDEA
Leveraging the latest technologies

By their own reckoning, banks are doing pretty well in adopting and exploiting leading edge technologies to help them make the most of their data, with predictive analytics, machine learning and alternative data sources all featuring quite strongly, as the findings of recent research on customer engagement showed.

<table>
<thead>
<tr>
<th>WHICH OF THESE CAPABILITIES DO YOU USE TODAY, DO YOU PLAN TO USE, OR ARE NOT ON YOUR RADAR?</th>
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</thead>
<tbody>
<tr>
<td>Predictive analytics to determine customer needs before they know them themselves</td>
</tr>
<tr>
<td>Using today</td>
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<tr>
<td>Machine learning to build customer understanding to support personalisation</td>
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<td>Will be using in 24 months plus</td>
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<tr>
<td>Analytics to extract insights from additional sources of data eg social to support personalisation</td>
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<tr>
<td>Analytics to extract insights from the banks’ own customer data to support personalisation</td>
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Source: Engaging the unengaged customer, a research paper from Finextra in association with SAP Hybris, issued in March 2017.

“Unless you have built your technology for a specific business model, it’s not plasticine: it’s very difficult to just change your technology — especially when you are serving millions of customers.”

CARLOS SANCHEZ, CEO AND FOUNDER OF IPAG00
There is no shortage of imminent deadlines and challenges to keep the payments professionals in Europe’s banks awake at night. Pan-European instant payments from November this year imposing an unprecedented performance requirement on systems... PSD2 mandating the opening up of account information and driving adoption of open APIs and strong customer authentication... ever-increasing demand from customers, retail and corporate, for better access, more information, value-added services... the list is certainly long.

However, difficult though this may be, the smart approach for banks right now is to take a step back from the immediate priorities, and think about the bigger picture of next generation banking. Yes, the demands of instant payments and PSD2 are many and far-reaching, and must be grappled with. But these two developments are also part of the much broader and more complex developing tapestry of the future of the financial services industry, and it is important for banks not to get so hung up on the detail that they can’t formulate a vision for their ongoing relevance in this fast-evolving environment.

For me, the critical question banks need to ask themselves is, how can they drive the digital agenda, and improve the consumer and corporate experience? Banks’ historical focus has been on holding money for their customers, and they have developed their strengths in core banking, and devoted energy to improving the way ledgers work.

Going forward, banks’ businesses are going to be much more about delivering great online, real-time, digital experiences to customers. The banking experience will be much more integrated into the rest of the world – into customers’ other interactions with different verticals such as retail and healthcare – and this must be done in a frictionless way. The future of banks will depend on their ability to leverage the trust they have and deliver a
seamlessly integrated banking and payments experience geared to making their customers’ lives easier.

In this context, the payments function will become ever more critical. Payments – how and why money moves – are all about the customer experience. Core banking is needed to hold money, but payments are at the forefront of any bank as it interfaces with the outside world.

Of course, it’s very easy to say that banks must not get caught up in the detail of immediate concrete challenges – but avoiding a preoccupation with the short term is hard to do. There is so much going on in front of and behind them – new schemes, new regulations, new technologies – and all of these factors influence the way in which banks can drive the digital agenda forward. A lack of clarity about what will happen is also a major challenge. We know that pan-European instant payments are coming, but there are question marks about how the pan-European schemes will work with domestic schemes and how the Eurosystem’s Target Instant Payments Settlement (TIPS) initiative will impact the landscape, given the likely appeal of leveraging central bank money.

There is an element of wait and see here – while banks know that they have to do real-time, that their clients will demand it, they also know that instant is not the only development they have to be ready for. The industry is buzzing with talk about what open APIs and open banking will mean for banks, and again, PSD2 compliance is a must-do, but it’s also new territory, and the impact it will have in practice is not fully understood.

One fact which does seem to be clear is that while banks are no longer losing as much sleep over the prospect of fintechs eating their lunch, their awareness of the competitive threat posed by other banks – those that make the right bets in these uncertain times – is getting far more acute. 2017 and 2018 are set to be challenging years, requiring banks to react rapidly to the directions the markets take. It’s unclear at this point what those directions will be, but when market changes gather momentum they can take off much more quickly now than in the past – banks won’t have long to react, and becoming more agile is a necessity.
When you enter into a market characterised by this level of uncertainty, you need modern tools at your disposal. In the absence of a crystal ball, banks need both strategic and operational agility, and at the heart of agility is a modern platform. For all the challenges, the changing environment also holds great opportunities for banks to provide tailored, more fine-grain payment and information services to customers of all kinds within the emerging ecosystem – but this is not possible if they are stuck with siloed legacy payments platforms.

As a consequence, we are seeing a shift in perception of payments modernisation programmes, from being a step some banks have feared to take to being a step they are determined to take in order to avoid missing out on the opportunities modernisation creates.

In short, payments modernisation is a key pillar for success in banks’ digital transformation programmes. One of the few certainties in this shifting marketplace is that the confluence of change drivers shaping the payments industry right now will be the catalyst for a wholesale move to the modern platforms that make possible so many new and valuable revenue generating opportunities for next generation banks.

“The payments function will become ever more critical. Payments — how and why money moves — are all about the customer experience. Core banking is needed to hold money, but payments are at the forefront of any bank as it interfaces with the outside world.”
The single biggest driver for change in European payments is the global trend of digitalisation. The effects manifest themselves differently for different customers. For consumers, the outcome is ever more invisible, blended, easy and seamless payments. For corporates, although we see a significant degree of ‘consumerisation’ shaping their demands – the benefits are more centred around enjoying optimised business processes. But the underlying driver for the changing experience of payments by customers of all kinds is digital disruption.

Digital disruption is reinforced by a number of other important factors of course. In Europe, the revised Payment Services Directive (PSD2) is in a sense turning banking inside out, transforming the landscape from a place where banks have been in control, to one in which new third-party entrants – and customers – have far more power.

In combination with moves to enable broader and easier access to the clearing infrastructure, formerly the preserve of banks alone, PSD2 – and the open banking that will result – are creating an environment in which the barriers to competition that banks used to enjoy are dissolving.

Indeed, the moat that historically surrounded the fortress of the banks’ businesses is gradually being bridged as the apparently unassailable truths of banking are challenged. It used to take tens and hundreds of millions of dollars to create a bank, but with modern technology easily in reach, today’s influx of neobanks is proving bottomless pockets are no longer a prerequisite. Even liquidity provisioning has been shown to be dispensable by the rise of marketplace lenders.
There are other challenges in the European payments landscape too. What will be the implications, for example, of the fracturing of the region into three broad blocks? As Europe settles into its divisions between the UK, the Nordics (or non-euro Europe) and Central Europe (euro-Europe), what will this mean for banks grappling with regulation designed to harmonise, and technology that makes a nonsense of national boundaries?

Europe is also – at the moment at least – being much more driven and shaped by regulation than other regions. Can Europe’s banks leverage the regulatory mandates to maintain and advance their relevance in a digitally-disrupted world?

As the traditional barriers to entry into banking are eroded, banks have no choice but to strengthen those that remain – and these are significant. The key reason for the banks’ existence is as a safe place for our money. We have trusted banks for a long time and that has not changed. Nobody is putting hundreds of thousands of euros, pounds or dollars into the safekeeping of fintechs.

Every industry goes through evolution and banking is no different, but when it comes to the central function of keeping money safe – and making payments – it is clear that the majority of fintechs are not well-known, and many of their business models are immature (at best). Banks have for hundreds of years, as regulated entities, kept our money safe and when it comes to our nest-eggs – as distinct from our speculative money – banks are the number one choice to protect it.

That is not to say that some fintechs won’t come to market with great solutions. They certainly will. But do they have billions of dollars to get the message out? Probably not – and this is where they can work with banks as distribution channels. This ‘platformisation’ holds out the prospect for some banks of differentiating themselves through their ability to bring the best fintech propositions to their customers, and puts the onus on effective collaboration between far-sighted banks and the most promising fintechs.

Without doubt, banks in this changing European – and global – landscape need to figure out what kind of business they want to be going forward. Certainly, they can try to ride out the disruption and do the minimum required to comply with changing regulation, but it is likely that among those that opt for this route we will see a fairly slow attrition that will accelerate over time, akin to the fate of ‘mom and pop’ businesses when larger competitors came to town.
To draw a parallel with retail, differentiating through price (like Tesco or Asda) or through a speciality (like Harrods) are still reasonable niches for banks to occupy. PSD2 creates the possibility of a new role – to become platforms (like Amazon). The exciting factor is that the field is wide open.

As well as settling on a strategy, to be successful going forward, banks will need to make the best possible use of the new tools that become available to them. In this context, real-time payments is a wonderful lever for digital disruption. Instant delivers what consumers, corporates and banks want, and it aligns well with PSD2 because it is a foundational element of the innovations made possible by open banking. Payment initiation and account aggregation services don’t really work without real-time payments being in place.

APIs are another important element of the toolkit, providing benefits such as unprecedented levels of straight-through processing (STP) that are achieved by enabling customer self-service. To fulfil their potential, APIs have to be easy to use, and provide value immediately. Cloud, evolving blockchain technologies, AI and tools to fight the cyber threat are also key parts of the solution – and here banks can rely on trusted partners with these weapons in their armoury, dedicated to supporting the banks on their journeys into real-time, open banking and digital disruption.

The current landscape in China – with the predominance of Alibaba and WePay – serves as a salutary lesson for banks as to what can happen if they don’t react to the digital disruption challenge. But they should have confidence that if they reinforce their historical strengths, put in the right strategic thinking about their next generation business models and leverage technology and partners in the right way to support them on their chosen path, then their future relevance as banks – and leaders in the payments industry – can be assured.
Are Banks on the Right Track with Their Approaches to Partnership?

The prevailing wisdom about the nature of bank-fintech relationships is that the spirit of these has changed for good – from one of competition to one of collaboration. But talk is cheap. How well are banks doing in forging these partnerships in reality – and what more do they need to do going forward to make partnering work within their payments businesses?

The potential for a win-win is certainly there, suggests Gavin Kelly, Director of Distribution Channels, Bank of Ireland. “What’s key for me is not to be afraid of innovation, to partner with fintech companies, to partner with new ideas,” he told Finextra. “We have a lot of experience in the banking industry, particularly in areas such as regulation, and we’ve got significant customer bases. We also have trust. So what we’ve got to do is use our strengths and to partner with new, innovative fintech companies to provide better solutions for our customers.

“I think that’s a real opportunity for the banking industry given the pace of change, to really use the partnership model, embrace it, and not be afraid of it, but to leverage it to drive new and innovative solutions for our customers.”

That may be the ideal state, but how close are banks to getting there? Kevin Brown, Senior Advisor, Global Payments, agrees banks have strengths to bring to the table. “There are certainly a number of interesting propositions coming from new entrants, but banks have a good record with data, settlement and security,” he says. There are, however, areas on which banks need to work harder – partnering being one.

“Banks need to adapt to working better with a number of different, agile partners. They have historically not been particularly strong at this and though, during the past two to three years they have improved, they still need to be smarter about working with third-parties to develop propositions for the API marketplace,” Brown suggests.
Realistically, banks do have strengths to leverage in the fintech battle, concurs Erkki Poutiainen, Strategy Manager, CM Customer Solutions, Nordea. “The competition we face as banks will evolve,” he predicts. “There will not be this feverish focus on fintech forever, and the situation will mature. Right now the low interest rates are making it easy for fintechs, but in two years’ time we may see a disillusionment set in if the expectations customers have of new applications are not met. We will then see a calming phase, as traditional and new players find their places.”

There has been a realisation of the need to work together on both sides, Poutiainen believes. “Few banks or fintechs are now thinking they can be self-sufficient: they all recognise that we need to partner to provide best of breed services. Together we are stronger. At the beginning we will see quite strong competition from fintechs, but let’s see how sustainable their models are.”

Nonetheless, there is no room for complacency, he cautions. “Right now everything is on the move and that creates a challenge for us. Standing still is no response to this: we have to find ways to move forward.”

Partnering for banks will not begin and end with fintechs, suggests Anna Puigoriol, Manager, Payments and Consumer Financing, Sabadell. “Integration between issuers and acquirers to unlock future opportunities in the payments business will also be an important goal,” she says.

“Our role in the future will be to become much closer to the merchants, providing the solutions they need, because not all merchants will want to become payments providers. We will have to be prepared to offer them solutions, because here our competitors are PSPs and they have been doing a very good job, very quickly developing new solutions,” Puigoriol continues.

“In the future I think we will see more agreements between PSPs and merchants and banks, and between start-ups and banks. Collaboration will be made possible by APIs, and everyone will need to try to understand which are the best partners: which of these companies can provide parts of the service better than I can?”

“IN THE FUTURE I THINK WE WILL SEE MORE AGREEMENTS BETWEEN PSPS AND MERCHANTS AND BANKS, AND BETWEEN START-UPS AND BANKS. COLLABORATION WILL BE MADE POSSIBLE BY APIs, AND EVERYONE WILL NEED TO TRY TO UNDERSTAND WHICH ARE THE BEST PARTNERS: WHICH OF THESE COMPANIES CAN PROVIDE PARTS OF THE SERVICE BETTER THAN I CAN?”

ANNA PUIGORIOL, MANAGER, PAYMENTS AND CONSUMER FINANCING, SABADELL
For the past three years, FIS has been surveying consumers – 8000 people in total, across eight countries – through our PACE research about their expectations of banks. This research has revealed a number of trends. One is that digital is not optional. Moreover, consumers’ expectations of their banks’ digital capabilities are increasing. What started as a requirement predominantly driven by younger people is now common to all segments, as Gen Xs’, Boomers’ and Millennials’ digital demands converge. In fact, seventy-five percent of all interactions with banks are now digital.

Millennials may have pulled banks into digital, but now the vast majority of their customers want to be able to use any service, anywhere at any time. Payments must be instant and frictionless, and if the customer experience doesn’t pass muster, the customer will move on to third party apps. Banks simply cannot ignore this trend, and, knowing what their customers want, must ask themselves whether they are satisfying their customers’ digital needs in an efficient way.

This is no easy task, given that banks are falling short on some of the basics such as service quality and security.

Another challenge for banks is pulling off this omnichannel feat efficiently in an ever-tougher competitive landscape. Ten years ago, the payments divisions of banks were typically among the top-three revenue generators. Fast forward to today, and payments divisions usually represent an overhead – as a result of cuts to potential fee earnings and the staggering cost of regulatory compliance. (Every day 200 pieces of regulation hit the banking and payments sectors globally.)
Imagine the difficulty for an organisation when the service its customers use most is one for which it cannot charge – and when on top of that, along comes a regulation which says, by the way, can you also open up and pave the way for attractive new entrants to easily offer innovative new products and services to those customers you have spent decades cultivating?

No one could argue against the over-arching aim of PSD2, to put power back in the hands of consumers. But this situation certainly represents a conundrum for the banks.

Though few of the disruptors will reach scale, incumbents should not ignore them. We have done some work recently with a start-up focused on helping customers clean up their financial acts, which aims to help them achieve ‘zero bad buy days’, by rating their transactions. In reality such a proposition might only appeal to a small percentage of the population but nonetheless would-be payments providers like these are clearly thinking about how to engage consumers in interesting and innovative ways.

Many new entrants are proving themselves better than most of the scale banks at understanding how to capture the attention of millennials and other forward thinking individuals in the digital economy – and the innovative approaches they develop could well be interesting to other customers too.

Therefore, banks must make sure they learn from the disruptors. They are doing this through their sandboxes – and they can leverage these efforts in the context of open banking, driven by PSD2 and underpinned by open APIs.

Much of the discussion about the challenge of APIs for banks has focused on the technology aspect. In fact, implementing APIs is relatively easy, given time and money to throw at the project. The real challenge lies in the governance, control and management of third party relationships. When it exposes APIs, a bank invites new players into a three-way relationship with its customers.

There are so many rules behind that which require management. How many hits must the bank allow before it can charge? Should a bank work with unregulated third parties? What levels and controls can customers themselves set?

Even when banks have validated TPPs and onboarded customers of those TPPs, the risk still remains with the bank. The controls required around this are incredibly complicated: management on a second by second basis, transaction by transaction.
In certain circumstances this could become very onerous indeed. Think about the Pokemon Go example. If a bank opens up and some consumer phenomenon suddenly generates millions of micropayments which start hitting the banks’ payments platform, this could have serious ramifications. The challenge of API governance notwithstanding, ‘fortress bank’ will simply not be a successful business model anymore. While the future is still taking shape, we can be pretty sure that when it comes to APIs, banks will go one of a few ways.

One option is to cease manufacturing any products and services and instead to buy services from others, and outsource the back office – including anything related to payment rails – in order to focus on the customer. A second is to concede the loss of the customer intimacy, acknowledge it is too difficult and complex to retain, and become a manufacturer, and a processor of payments and other banking services. We already see a couple of larger banks thinking along those lines.

A third is to take a bit of both – and of course this hybrid model is the one every bank will have to implement in the short term.

The likely winners in the world of open banking will be organisations with the financial muscle to build an ecosystem containing all of a customer’s main providers, in order to paint a complete picture of that customer’s activities. As a consequence one of the biggest threats to banks could come from the large consumer brands – the GAFAs. They can embed the payments and banking services into the context of where they are needed – by taking banking APIs, investing in their own proprietary APIs, and performing multi-provider aggregation, as well as offering PISP services.

The good news for banks is that the business models of tomorrow haven’t been invented yet. It’s all still to play for. In the short term, banks must comply with PSD2 and deal with the challenge of API management and governance. That is where the risk is: banks simply cannot provide uncontrolled access to their APIs.

In parallel, banks must determine their business strategies for the medium to long term, while also ensuring their technology strategies fit them to deploy open APIs in a world of instant payments. The business model options are many and varied, and while there is no magic bullet for success, a clear prerequisite is to master open APIs and real-time as the fundamentals for a modern payments provider.
ENSURING A GOOD CUSTOMER OUTCOME FROM SCA

By Jason Lane, Executive Vice President, Market Development Europe, Mastercard

So much of the discussion about the impact on the industry of the revised Payment Services Directive (PSD2) has focused on the account to account (A2A) provisions and what they mean for PSPs, banks and acquirers that it is easy to overlook the regulation's other implications for customers.

It is very important not to do this. As well as encouraging competition in the European payments landscape, PSD2 is aiming to improve consumer protection, and in this regard its provisions in the area of strong customer (or cardholder) authentication (SCA) are every bit as critical as those around A2A.

Where PSD2 focuses on measures to drive down fraud and better protect the users of payment services, it has the potential to fundamentally change the customer experience – and this must be done in the right way if the customer experience is to improve and not diminish.

The first point to make is that two-factor authentication, where users must prove their identity in two out of three ways (something they are, something they have and something they know), is a highly effective way of driving down fraud and benefits consumers, merchants and banks.

The challenge lies in how two-factor authentication is implemented, in order to ensure strong consumer acceptance and adoption. Today’s customers are used to seamless engagement and frictionless transactions. Think about Amazon one-click.

If SCA as implemented under PSD2 adds more friction and puts impediments in the way of seamless engagement for customers, then consumer acceptance and adoption will suffer. If SCA is not implemented well – or indeed if it is
implemented differently across markets, market participants and payment types – customers will be alienated or confused or both, and will abandon their transactions.

In other words, an intended fraud prevention technique, if not implemented correctly, could rapidly become a business prevention technique.

The solution is to ensure an approach that allows enough freedom to create implementations that will appeal to consumers, increasing their safety and security, while allowing them to transact in ways they appreciate today. The approach should also ensure consistency of application in different countries, for different players and around different payment mechanisms. A global online retailer with the ability to deploy sophisticated risk-based algorithms should not be allowed to impose less rigorous identity checks than a small e-commerce player operating in a local European market.

By the same token, consumers should not have to go through a more complex authentication process for a card payment than for an account-to-account instant payment – especially given the fact that far more customer protections are already in place around card payments than they are around irrevocable payments directly from bank accounts.

The European Banking Authority (EBA) has undertaken a very long and in-depth consultation process in order to formulate the Regulatory Technical Standards (RTSs) for SCA – and indeed it has never had as much feedback on any RTSs as it has on these – so we have to recognise that SCA is a complex and somewhat controversial area.

It is therefore essential to keep in mind what consumers want – a simple, smooth, protected payment experience, that is the same across the single market area, and does not discriminate against one payment method or another.

If consumers are exposed to payments experiences that fall short of this requirement, then we will see a rise in abandonment of sales, as what started as really good thinking about how to improve consumer protection turns out to have really bad consequences as a result of poor implementation. The good news is that the fraud prevention mechanisms we have today around biometrics for example are both safe and convenient, and have great potential in the fight against fraud as standards for their roll-out across the entire industry go from strength to strength. An authentication roadmap, designed to preserve the good balance between security and user experience, will also drive positive benefits for consumers and the industry as a whole: when this balance is right, then the effectiveness of anti-fraud measures is optimal.
In short, the smart implementation of fraud prevention techniques that achieve strong customer or cardholder authentication, while also maintaining a great customer experience, is the way forward to both protect consumers and enable them to pay in the ways they like, where they like, when they like – bringing to life all the aims of PSD2 and spurring on the growth of e-commerce in Europe and beyond.

“Consumers should not have to go through a more complex authentication process for a card payment than for an account-to-account instant payment — especially given the fact that far more customer protections are already in place around card payments than they are around irrevocable payments directly from bank accounts.”
ARE BANKS SO CAUGHT UP IN THE DETAIL OF PAYMENTS CHANGE THAT THEY HAVE LOST SIGHT OF THE BIGGER PICTURE?

Yes, possibly. As Leo Lipis, Founder of Lipis Advisors, says: “It’s the immediate concerns – PSD2, access to accounts, instant payments – that are keeping payments practitioners awake at night, and this makes it challenging for banks to put enough thought into the long-term threat to the franchise all this payments change could represent.”

Indeed, “the biggest challenge today is to balance the needs of our current business with working out what the industry will look like in the future”, believes Anna Puigoriol, Manager, Payments and Consumer Financing, Sabadell. “Payments today, the same as last year and the year before, is a profitable business, but we know that we will see changes in the future – different profitability and, probably, revenues coming from different areas, as interchange fees shrink and even disappear. The transition from one business to another won’t take place overnight – and we cannot think either just about the present or just about the future,” she says.

“When it comes to making investment decisions, it is impossible to know which solutions will turn out to dominate. Cards? Instant payments? Issuers’ wallets? Merchants’ wallets? We know the payments business will change and that probably we will see all these instruments playing a role, but which will be the winner? It will be the market which will determine what will be the solution that will predominate, that one that offers the customer an easier, simple and faster use. This will be the key to success,” Puigoriol adds.

Erkki Poutiainen, Strategy Manager, CM Customer Solutions, Nordea, agrees that “there are very few certainties”. Banks therefore must “work out how to develop our business models to secure the future for our institutions”, he says. “Not all banks will take the same path, and if we take the predictions seriously, there is a chance that banks become the backbone of the industry, while the cream becomes someone else’s business.”

This uncertainty notwithstanding, it is also true that developments like the revised Payment Services Directive (PSD2) have gone further than earlier change drivers in terms of penetrating the consciousness of the C-level of
**Positive perspectives on PSD2**

Overall, banks seem to view PSD2 and open banking as helpful developments, and developments which they are well-positioned to prepare for and make the most of, according to Finextra research among transaction banks in early 2017.

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### PLEASE INDICATE WHETHER THE BELOW FACTORS WILL MAKE YOUR ORGANISATION’S TRANSITION TO OPEN BANKING EASIER, OR MORE DIFFICULT.

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Source: Transaction banking in an open, connected world, a research paper produced by Finextra in association with Misys.

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“The instant payments debate is not just about speeding up the same old processes — it should be about rethinking the value proposition towards customers. Just speeding up the same processes is not good enough to compete in the digital era. Banks should use the opportunity to rethink their business and operating model and determine what strategic niche they wish to occupy in a wider ecosystem.”

DANIEL SZMUKLER, DIRECTOR, EURO BANKING ASSOCIATION (EBA)
banks. Says Poutiainen: “There is a strong understanding at a senior level in banks about the implications of PSD2 for our business. I was at the heart of SEPA, within the bank and at an industry level, and I thought this was a revolution, removing country borders, but it wasn’t a wake-up call for the top level. Now at banks the chairman of the board and the CEO know what open banking is, what PSD2 is. These developments have become very close to their daily concerns.”

That does not mean that payments teams are home and dry in terms of securing the investment they need to make the changes required in the face of developments like PSD2 and instant payments, however. “The reality is that with so many things going on, even if payments people are unanimous about how to get ready for PSD2 and open banking and instant payments, getting the right things done, getting the funding for them, is still a challenge. There is still internal competition for budgets, and it’s likely that not every bank will be able to take the optimal approach to prepare. Quite a number might have to put in place a quick solution and leave the way to the ultimate goal to be completed later,” Poutiainen suggests.

This constraint on investment in the future of payments needs to be tackled, suggests Jeremy Light, Managing Director of Accenture Payment Services in EMEA. “Payments have always been important to banks. It’s why people have bank accounts: to get paid and pay others. The payments part of the interaction is the fuel for banks to keep the customer relationship – and they need the right propositions to do that. Banks have not been able to push payments innovation up the prioritisation list because of regulatory change on one hand and the legacy challenges on the other – but that needs to change,” he says.

In certain markets like the UK the weight of change under way demands proper engagement, believes Becky Clement, Head of Industry Engagement and Payment Change, Metro Bank. “After 20 years during which nothing much has changed, the next two years in the payments industry will be really important,” she says. “The industry must get this right – the new RTGS, the single payments architecture for retail payments – because these developments could be a gamechanger. We should all be reading as much as we can and contributing as much as we can to ensure we have the right insights into and influence over these really interesting and important developments.”
One challenge banks face in responding to payments change with the strategic foresight that is required lies in the fact that the idea of there being a common view across a bank could well be a myth. “When it comes to responding to these developments, there is no one view from within a bank about how or whether to do it,” says Jonathan Williams, Principal Consultant, Mk2 Consulting. “If you talk to people in a large commercial bank you will get a spectrum of responses. We are seeing this very clearly with PSD2 and open banking, with some saying we have got to do this but let’s do the minimum and others within the same bank saying let’s do it and integrate partner services as well. In some banks there may be three or four different views about what to do about open banking.”

Formulating a strategic view is however critical, argues Daniel Szmukler, Director, Euro Banking Association (EBA). “With instant payments, the time and distance constraints are gone,” he says. “The instant payments debate is not just about speeding up the same old processes – it should be about rethinking the value proposition towards customers. The time needed to execute a payment end to end is being compressed into a few seconds. Just speeding up the same processes is not good enough to compete in the digital era. Banks should use the opportunity to rethink their business and operating model and determine what strategic niche they wish to occupy in a wider ecosystem,” Szmukler adds.

“After 20 years during which nothing much has changed, the next two years in the payments industry will be really important. The industry must get this right — the new RTGS, the single payments architecture for retail payments — because these developments could be a gamechanger. We should all be reading as much as we can and contributing as much as we can to ensure we have the right insights into and influence over these really interesting and important developments”

BECKY CLEMENTS, HEAD OF INDUSTRY ENGAGEMENT AND PAYMENT CHANGE, METRO BANK
There has been a great deal of discussion in the industry about why instant payments are so important. There are clearly a number of drivers for the move to instant, but the most powerful underlying reason why real-time is inevitable is consumer behaviour. This is changing. Young people – all people – want everything now. We don’t want to wait. We want to access any service, any time, anywhere. Nurtured by the spread of mobile and the service ethos of the GAFAs, this customer expectation is the new normal.

Given the growing war on cash, this demand is driving the need for instant electronic payments mechanisms, capable of replicating the buying experience we are used to, of paying quickly and easily – and instantly – for numerous low-value items a day.

There’s no doubt banks across Europe have to be part of this, but beyond that obligation, are there real opportunities for banks in the real-time payments business? We believe that there are, especially in the context of a historically low interest rate environment which is robbing them of a strong former source of income.

One lies in the tracking that is possible when low value payments move to electronic instant mechanisms. If people pay in cash it is impossible to know how they are spending their money. If, by contrast, they use electronic payments means, then it is possible for banks to track spending behaviour and from that data generate targeted marketing campaigns and drive up revenues.

This is a very concrete business opportunity for banks, especially as we don’t believe that in the near future at least instant payments will cannibalise card
businesses (with card payments concentrated mostly at physical acquirers). Another opportunity relates to the customer data owned by the banks like the International Bank Account Numbers (IBANs) required for instant payments. These are long and not easy to manage, and therefore banks could also develop services based on linking IBANs to other proxy agents that are easier for customers to remember and manage, such as mobile phone numbers.

Banks, leveraging the trust they enjoy in the market, could consider IBANs as an important asset to be transformed into services around identity, and indeed some early mover banks have already understood this opportunity and have begun to develop such services.

A third opportunity for banks to drive new revenue opportunities off the back of instant payments is supporting the growing marketplace for services on demand. If a consumer wants immediate insurance to cover them for an extreme sport they are about to participate in, then immediate payment is required to secure it. As the car business changes and shifts from consumers buying cars to buying car services – a cabriolet on a sunny day and a Range Rover on a winter’s day for example – insurance for that one day won’t be available instantly unless payment can be made instantly.

In short, the way we are buying goods and services is changing, and payments need to keep up – creating a business opportunity for banks that spot the opportunity and take the lead.

The move to instant payments clearly requires market infrastructure, and given the developments under way in Europe at the ACH and pan-European clearing and settlement levels, the necessary interoperability and competitive pricing models are likely to be in place in the next year.

But that is only one part of the picture. Far more complex for the banks is how they manage instant payments in their own shops. Yes, many banks have invested heavily in SEPA capabilities – but there is a big difference between a ‘traditional’ SEPA payment and an instant payment. All AML controls need to be done in a shrinking window, liquidity management has to be done differently and operations have to be 24x7x365.

Banks will have to monitor their transactions to ensure they are meeting demanding SLAs which will be challenging enough in the areas of the infrastructure they themselves control end-to-end – their own online and branch networks. But with the move to the revised Payment Services Directive (PSD2) and the opening up of accounts to third parties, banks will also have to handle and monitor numerous transactions from channels beyond their control.
If a PISP is accessing customer accounts and a merchant is doing a promotion akin to those on Black Friday, there could be an explosion of transactions from new channels, creating an almighty headache for banks that have to keep control of SLAs and carry out monitoring.

The future, as we see it, is instant payment as a service, with banks outsourcing these activities to specialist providers with transaction processing as a core business and long-standing, proven capabilities to handle real-time – and play a key role in the development of secure and reliable instant payments infrastructures. These providers should offer easy API-driven integration between banks’ systems and their processing engines, as well as volume-based pricing, with decreasing tiered prices as volumes grow.

At the front end, banks face increasing competition from new entrants, even tech giants. They need to put all their strategic effort into developing innovative services that will leverage instant payments capabilities to retain customers and customer loyalty in the face of these competitors – whether that be instant lending, supporting services on demand or proxy services for payments and identity.

The banks’ future lies in leveraging all the assets they have around accounts and digital payments, and to free themselves up to do this, they can outsource their legacy and instant payment processing to specialist infrastructure providers such as SIA, reducing their go-to-market, in order to focus on knowing – and serving – their customers, in an easy way.
VIRTUAL ACCOUNT MANAGEMENT: A FIRST STEP TO INNOVATION AND STRATEGIC REPOSITIONING

By Sheri Brandon, Head of Transaction Banking, Financial Services, Tieto

Considering the huge emphasis banks have put on innovation in their retail businesses in recent years, it is somewhat surprising how little real innovation there has been in the corporate cash management business during at least the past decade.

Innovation is no less needed in the corporate cash management space. Banks are under margin pressure and must both generate new sources of revenue and significantly increase efficiency. Regulation such as Basel III is creating a number of challenges – and corporates, like consumers, want mobility: access anywhere and any time (in real-time) to their accounts.

The good news is that virtual account management (VAM) is an increasingly viable option for banks looking to drive innovation in corporate cash management – and beyond. VAM can be a first step for banks seeking to position themselves differently from a strategic perspective.

By leveraging VAM, banks can drive multiple propositions from a single platform, achieve flexibility even despite legacy restrictions, pursue an incremental implementation and achieve operational change. Furthermore, VAM can ease banks’ compliance challenges and help them counteract falling revenues by unlocking new revenue sources and enabling data aggregation, data segregation and data visibility.

VAM can also enable banks to improve life for their corporate customers by enabling self-service and automation, real-time access and mobility. Consider
the fact that the average corporate has somewhere between 500 and 2000 bank accounts. Very large corporates, working across the globe, with multiple accounts in each region, could notch up 20,000 to 30,000 accounts.

What these corporates want is to be able to optimise their accounts and centralise transactions, payments and receivables, and in so doing to vastly improve efficiency. Many corporates are forced to work with multiple banks to meet their credit needs, but do not want the overheads of activities such as administering intra-company loans that go with this approach. Rather, they want to be able to connect multiple banks via one solution.

In a typical treasury operating environment today, all entities within the group maintain separate bank relationships and bank accounts, with all payment activity managed by each entity and no consolidation. Traditional cash management facilities (such as pooling and sweeping) are used to provide excess funds to group treasury, but there are inherent delays in the availability of information and inherent cost and risk as a consequence of a lack of visibility on funds.

In a treasury environment transformed by VAM, bank relationships and real accounts are managed centrally, with regional subsidiaries and intra-company transaction flows managed through virtual accounts. Full cash and liquidity management facilities are implemented virtually, with real-time visibility of all virtual account information and significant cost and risk reduction resulting from this new operating model.

VAM can also be an effective response to changes in the environment driven by regulation. For example, liquidity management practices are shifting as a result of Basel III, which is making the historically popular practice of notional pooling more expensive (because each current account position is considered separately under Basel III). In turn, physical pooling is likely to become more desirable – and VAM offers an alternative to this, requiring no balance offset from the bank, since cash is located only on the current account.

Another significant regulatory headache – that of KYC – can also be eased by VAM, with one of the many efficiencies VAM brings being to streamline account opening by obviating the need for much of the paperwork required to open an account in a non-VAM environment.

In order to leverage the potential of VAM, banks of course need the right systems in place, and here, as usual, they have two choices – to buy, or to build. Some banks have taken the second route, but this comes with significant challenges. It’s only possible to do at all if the bank’s core system
allows it. Not all do. Even when the core banking systems do support such a build, the time to market is long. We have heard of projects taking two years. By contrast, the buy option can be far quicker and simpler, requiring little or no change to core banking systems. Putting a VAM engine on top of a core system means banks don’t need to do any integration.

A VAM engine which sits between key components of banks’ current infrastructures – the core system and the customer facing system – can be implemented without impacting existing systems at all, which means minimal changes are needed.

As banks look to their futures – and how to reinvent their businesses to thrive in the digital world – they have to consider how they will drive innovation in corporate cash management as well as in other key areas within their transactional activities, including correspondent banking.

Being able to quickly harness the power of VAM to improve efficiency, drive new revenue sources and enhance service provision to increasingly demanding customers will be vital for banks looking to remain relevant in the fast-changing times ahead.
1) **Think about the future as well as the present, and think about payments change holistically.** Don’t get too caught up in the detail and lose sight of the bigger picture, and leverage what you do for instant payments for PSD2 and vice versa to unlock the biggest potential opportunities from these developments.

2) **Get out of the race to the bottom by focusing on the data and the value-add.** Find ways to embed payments, extend payments, improve the safety of payments and remove the pain of payments.

3) **Collaborate with and listen to your customers to dentify future business models that will enable you to make payments a business again.** Customers need payments and if you take the time to find out what they want, can point you in the direction of fruitful new ways of working.

4) **Modernise with speed – but care.** Leverage new technologies such as cloud to control costs and create agility in your platforms, so you can manage the change you know about – and the change you can’t foresee – in an efficient and effective way.

5) **Partner with fintechs, merchants, other banks – any entity able to perform a part of the end-to-end transaction better than you can.** This will help you secure your role in the digital ecosystem and deliver the innovative new paym
CONVERGENCE: DRIVING EFFICIENCY AND RELEVANCE IN THE EVOLVING PAYMENTS LANDSCAPE

By Paul Stoddart, Chief Executive Officer, Vocalink

The payments business for banks is changing – rapidly. In part, this is being driven by evolving customer demand for convenience and control. Another key driver is regulation of course, in particular the revised Payment Services Directive (PSD2), which requires banks to rethink both their technology and business models in relation to payments. Technological advancement – and the effectiveness of fintech new entrants in leveraging it – are also setting the pace, and underpinning the inexorable rise of instant payments across the globe.

In the face of speedy technological development, more demanding regulators and customers and new entrants hungry to gain new business, the imperative for banks to increase the efficiency of their payments operations has never been stronger. In addition to taking out costs, banks also need to build in additional capabilities to stay relevant in the far more intensely competitive payments landscape being shaped around them.

The convergence of historically separate payment networks is, in this context, a critical development. As we all know, during the past 40 or so years, two payments networks have been built up – one for card-based payments and one for ACH payments. Broadly speaking these networks have started domestically and spread outwards to offer cross-border and international capabilities – but the two worlds have remained separate from each other. The next phase of evolution of these infrastructures is the convergence of major global card-based networks and real-time ACH networks, with the goal of creating a global, real-time payments network that leverages the best of both the card and the ACH environments.
We know that customers – both consumers and businesses – do not care about how their payments are made, as long as they get what they want, but in the background, the seamless bringing together of card-based networks and ACH networks enables the creation of real value for banks and their customers.

For banks, it opens up the prospect of being able to work with a single partner to meet all their payments needs. Banks need to be able to offer both card based and ACH payments capabilities through their retail banking apps and their corporate cash management solutions, and being able to leverage a single, primary relationship with a strategic partner clearly creates the potential for improved efficiency and effectiveness.

Of course this requires some rethinking by banks about how they view their payments function, where – and how high up – in the organisation responsibility for payments systems sits, and how to break down existing silos within the bank to leverage the convergence on offer. However, we are already seeing front runners absorb this, begin the move away from siloed thinking, and reflect the changing role of payments by appointing executive level leadership to the function.

There is clear evidence that these leaders are acquiring the ability to both rapidly reduce costs and increase revenues, helping to shift payments away from being a pure cost centre back towards revenue generation.

Converged technologies enable banks to conceive of – and actually offer – complete straight-through processing (STP) to all customers, from the biggest to the smallest. The opportunities for elements of the payments process to go awry is vastly reduced, leading to fewer errors, less need for costly exception handling, reduced chargebacks and misdirected payments and lower levels of fraud. Together these improvements significantly increase the efficiency of payments operations.

Convergence also makes possible the consolidation of internal technology systems – the replacing of siloed systems for card-based payments, business payments, domestic ACH and cross-border ACH payments with a single technology solution for all payments. The prospect of deploying a single technology stack is a massive cost reduction opportunity.

On the revenue side, the banking industry has so far only scratched the surface of the new business opportunities made possible by a global real-time payments infrastructure. For consumers, the emphasis has to be on digital, and making services fast and slick. For businesses, banks can leverage real-time to do vanilla payments more efficiently, and can then develop value-
added retail and B2B services using the data layer capability of a modern ACH infrastructure.

It is natural for banks to be concerned that they might be foregoing existing revenue streams through these developments, and the pragmatic answer to that question is that yes, they probably will be in some areas – but it will be less than they fear and better for them to disrupt themselves than wait for new entrants to snatch revenues away from them.

In our conversations with banks globally, a consistent request is for assistance in developing a platform to underpin the innovation that will protect them against the new entrants and enable them to compete more effectively, by creating new services to drive new revenue streams.

Convergence of networks is a critical component of this platform. Banks are coping with the global rise of instant payments and the implications for their technology – and their business models – of the move to open banking underpinned by open APIs.

Convergence of networks provides a solution to today’s technology challenges and creates a platform for renewed payments efficiency – leaving the banks free to focus on those all important strategic decisions about new products and new revenue streams, as they carve out roles for themselves in the evolving digital ecosystem and seek to remain relevant to customers of all types in the future payments landscape.
Think strategically, not tactically

Market commentators have been asking banks to look at all the changes coming down the line in payments as part of a strategic whole, and research done by Finextra earlier this year suggests banks might be listening.

"Don’t get too caught up in the detail and lose sight of the bigger picture, and leverage what you do for instant payments for PSD2 and vice versa to unlock the biggest potential opportunities from these developments.”
The challenges of big data analytics in the real world

Banks recognise the potential of their data to help them identify new opportunities in payments, and to deliver better services and experiences to their customers. However, leveraging that data in practice is not always straightforward, as the findings of a recent Finextra survey showed.

### PLEASE INDICATE HOW MUCH THE FOLLOWING INTERNAL FACTORS ARE CREATING CHALLENGES FOR YOUR FIRM IN REALISING ITS BIG DATA ANALYTICS VISION.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Not challenging at all</th>
<th>Proving a little challenging</th>
<th>Proving somewhat challenging</th>
<th>Proving very challenging</th>
<th>Preventing any progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>The time it takes to receive approval to use sensitive data</td>
<td>15%</td>
<td>16%</td>
<td>26%</td>
<td>33%</td>
<td>10%</td>
</tr>
<tr>
<td>The level of support and conduciveness of culture to use data</td>
<td>17%</td>
<td>20%</td>
<td>31%</td>
<td>29%</td>
<td>3%</td>
</tr>
<tr>
<td>Managing multiple vendors</td>
<td>22%</td>
<td>24%</td>
<td>33%</td>
<td>18%</td>
<td>3%</td>
</tr>
<tr>
<td>The level of knowledge about analytics and the availability of training</td>
<td>20%</td>
<td>19%</td>
<td>41%</td>
<td>17%</td>
<td>3%</td>
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### PLEASE INDICATE HOW MUCH THE FOLLOWING EXTERNAL FACTORS ARE CREATING CHALLENGES FOR YOUR FIRM IN REALISING ITS BIG DATA ANALYTICS VISION.

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<th>Factor</th>
<th>Not challenging at all</th>
<th>Proving a little challenging</th>
<th>Proving somewhat challenging</th>
<th>Proving very challenging</th>
<th>Preventing any progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing customer concern over the processing of their personal data</td>
<td>11%</td>
<td>25%</td>
<td>29%</td>
<td>33%</td>
<td>2%</td>
</tr>
<tr>
<td>Preparing for GDPR by understanding what use of personal data for analytics is permitted and which aspect will further control use of sensitive data</td>
<td>11%</td>
<td>36%</td>
<td>22%</td>
<td>26%</td>
<td>5%</td>
</tr>
<tr>
<td>Current legal constraints around use of customer data</td>
<td>5%</td>
<td>20%</td>
<td>45%</td>
<td>23%</td>
<td>7%</td>
</tr>
<tr>
<td>Availability of technology to underpin big data analytics and data privacy</td>
<td>13%</td>
<td>31%</td>
<td>36%</td>
<td>18%</td>
<td>2%</td>
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Source: Tackling data privacy to unlock the power of big data analytics, a research paper produced by Finextra in association with Privitar in May 2017.
**Finextra**

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