

Research report by Finextra Research, in association with Tietoevry
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DEFINITIVE DIFFERENTIATORS- FORGING A FUTURE-PROOF PAYMENTS MODEL

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01

Foreword



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Over the last few decades, banks have been forced to reconsider their business model for transaction services. During the era of low-interest rates, the focus shifted to transaction revenues, and while the pendulum is now pivoting back to utilizing the balance sheet for revenue growth, the amount of new regulations impacting the industry is ever-increasing. New technology and market regulation have fostered innovation and new market entrants. This “perfect storm” is exposing a number of potential threats for banks, but also new opportunities to expand the share of customer wallet and time to market, and drive cost efficiency through standardization.

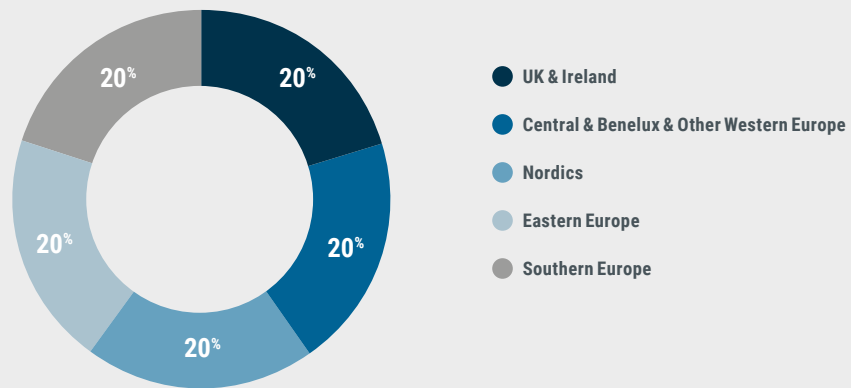
As banks reconsider the importance of payments for executing their business strategy and model, this typically calls for a change in the operating model. This survey speaks to the fact that the changing business model of payments is the single most important factor for banks to change their operating model, followed by the desire to lower costs. The options range from internalizing IT and operations to banks that are looking to outsource parts or all of the payment operations. While the survey clearly shows that banks have already embarked on the journey of outsourcing, especially in back-office operations and customer service, the availability of standardized payment services, such as Payment as a Service (PaaS), is gaining traction and is increasingly being considered by banks. While, for some time, the payment infrastructure has been offered as a managed service, a few vendors are now also adding operational capabilities.

02

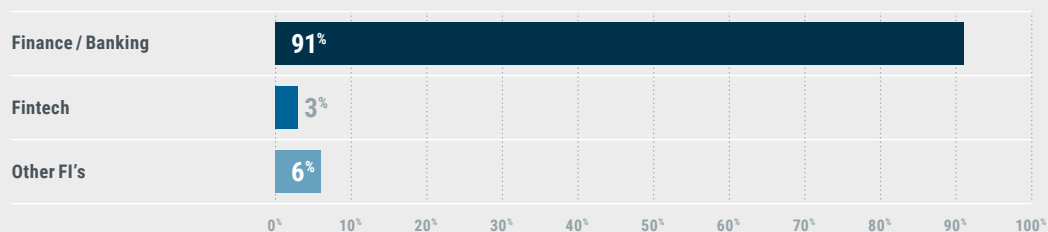
Methodology

The payments industry is fast proliferating. From regulation to technology and emerging market forces, the business of moving money is in flux, and with it, operating models need to be adjusted more than ever with the future in mind. This survey from Finextra Research, in association with Tietoevry, probes and seeks to define the key factors driving changes to models for different financial institutions and how they can wield continued or differentiated success in the evolving landscape. The report is based on a survey sample of 150 European Financial Services and Payments professionals.

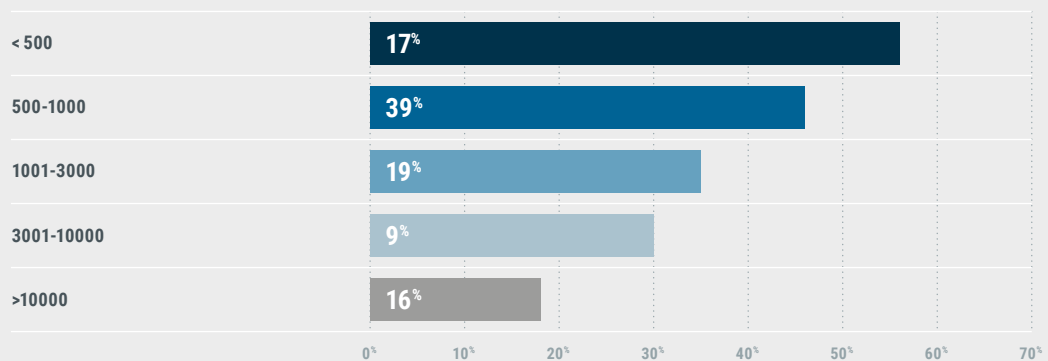
IN WHAT REGION DO YOU PRIMARILY OPERATE?



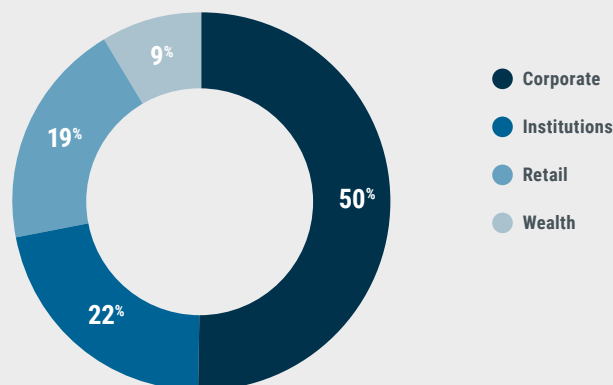
WHICH SECTOR DO YOU WORK IN?



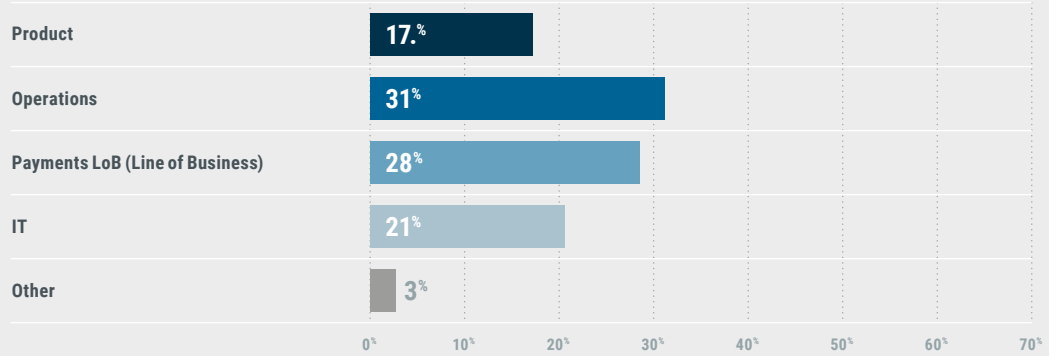
WHICH BEST DESCRIBES THE SIZE OF YOUR ORGANISATION (EMPLOYEES)?



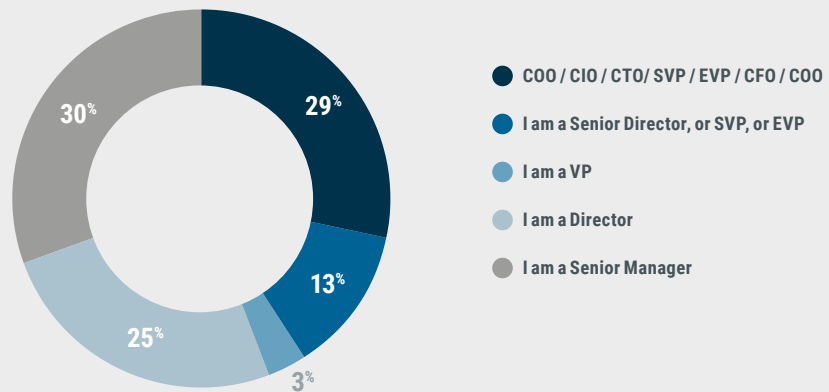
WHAT ARE THE PRIMARY CUSTOMERS YOUR INSTITUTION FOCUSES ON?



WHICH BEST DESCRIBES YOUR CURRENT FUNCTION?



WHICH OF THE FOLLOWING BEST DESCRIBES YOUR CURRENT ROLE?

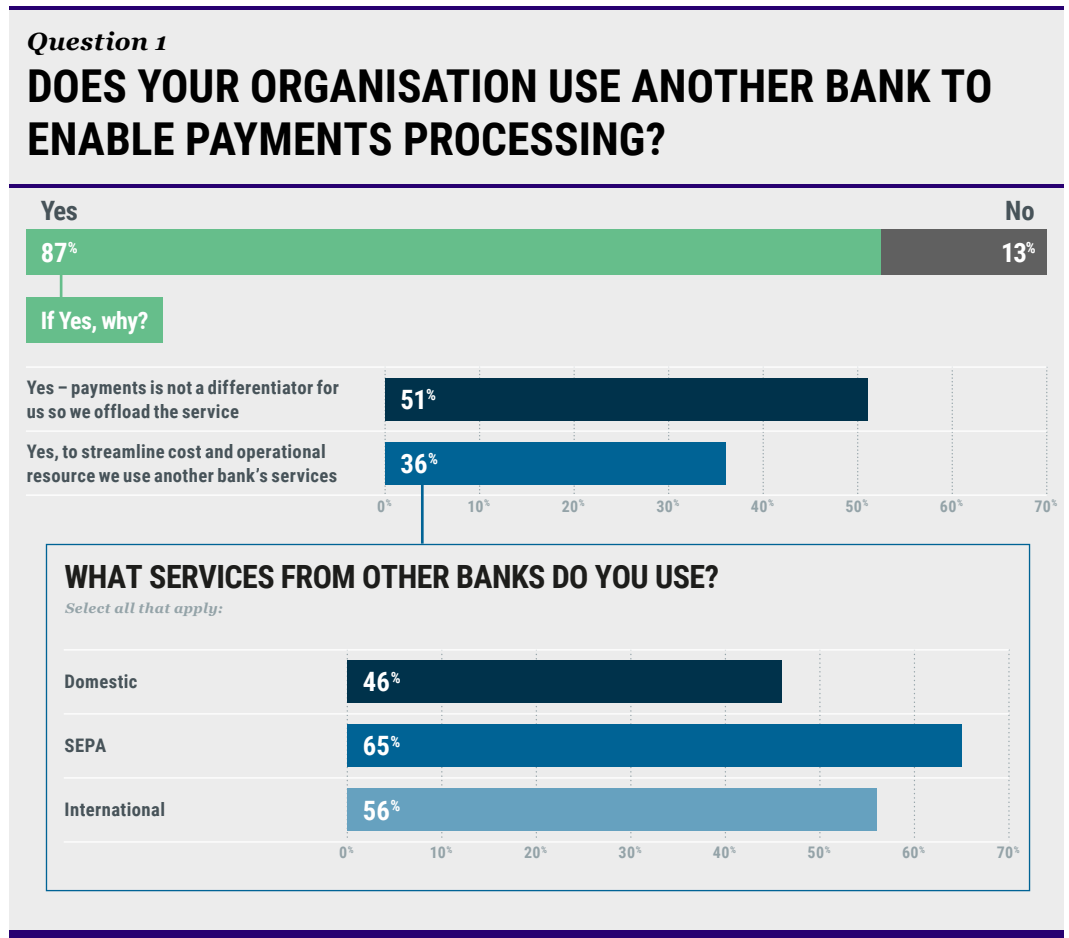


03

Differentiating through partnerships

Payment methods and cross-country transactions continue to grow in volume and value, presenting both complex challenges and significant opportunities for all kinds of players in the industry. Partnerships and collaboration have become a key component of operating models enabling organisations to hone their unique offering and evolve, fast. For some, the payments components is a key differentiator; for others, not so much. Globalisation and technology have paved the way for proliferated and dynamic new business models.

Eighty-seven per cent reflects the extent of banks using other banks to execute their offering. It reflects the choices that are often made by organisations to focus on their unique offering. Where payments is not a differentiator, customer experience may be, or the development of new products or niche services- hence choosing to offload payments. Outsourcing has become a common practice for banks as the industry becomes more open, more collaborative, as technology has enabled easier connections and integrations and as the service offerings have become more differentiated.



Just over half of those (51%) who use another bank for their payments processing say payments is not a differentiator. This at the very least shows how complex an undertaking and also how huge an operational function or burden payments are for all organisations.

Thirty-six of the 87% that offload payments processing do so in the name of streamlining the cost and the operational resource associated with payments. Also, of course, reflective of the limited internal resource and capacity some banks have at all to process payments. Given the market change and the proliferation of players and specialists that provide payment services, this isn't a huge surprise albeit interesting to consider in percentage terms. Banks of course are not the only organisations offering payment products and services to other banking institutions and in some instances, IT service providers are also a frequent choice for outsourcing partnerships due to their relative neutrality vis-a-vis corporate competition and technical agility.

There has been a trend towards farming out A2A (Account to Account) payments to payment processors, which is similar to what has happened in the card market. As we find here, many banks do this already at least partially.

However, we can infer that offloading payments processing enables banks to focus better on other defining USPs of their service offering.

SEPA is a priority for which to use the services of other banks to specialise. It is clearly a priority to deal with cross border payments, perhaps because this is something that has been added on to their service since inception. Also likely due to increased international payment activity and for the significant real time payments demand and ISO migration. This goes for retail, corporate, wealth, and the institutions will likely follow.

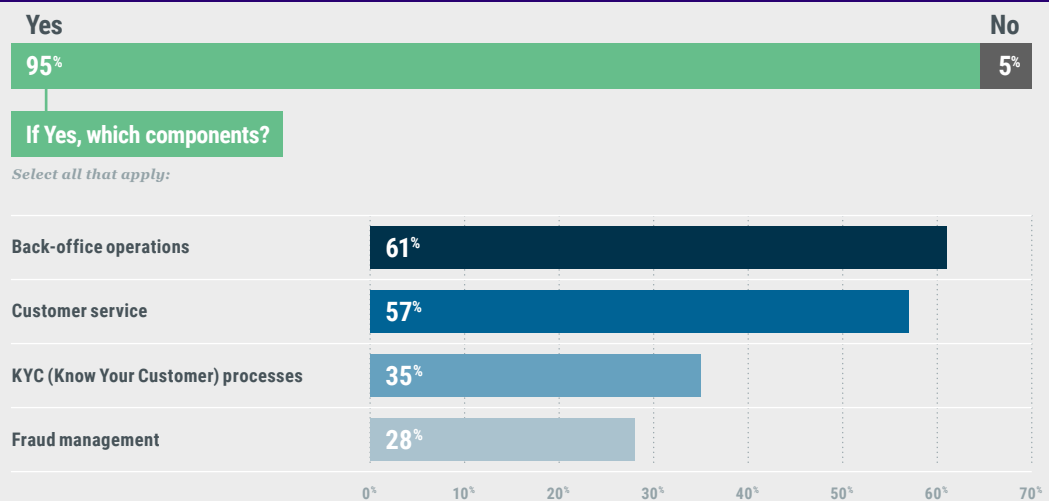
04

Business and operating models still driven largely by security and risk perceptions

Regarding outsourcing, different organisations will have different criteria and qualifying questions as to what kind of provider they would choose, what kind of scalability they are looking to maintain or achieve, and whether they want to compete with dedicated outsourcing players or not.

Question 2

DOES YOUR ORGANISATION OUTSOURCE PAYMENTS PROCESSING COMPONENTS?



Back office operations are the most popular payment processing component that respondents' banks outsource. This, again, speaks to the sheer undertaking of maintaining legacy systems and the urgency in wielding value from new technologies and data by modernising them. It could also be further evidence that payments are not a great differentiator for many banks.

Outsourcing has proven itself to be an extremely successful business model over the years, either project-based or individual components, and not only for banks. It allows organisations to plan internal resources smarter and gain access to expertise beyond their own. And scouring the market to select the most appropriate partner for the component or project in question, be that traditional bank or IT specialist provider.

Fraud management is the least popular component to be outsourced, at 28%; KYC processes the second least, at 35%. Organisations are just over twice as likely to outsource back office operations as fraud, at 61%.

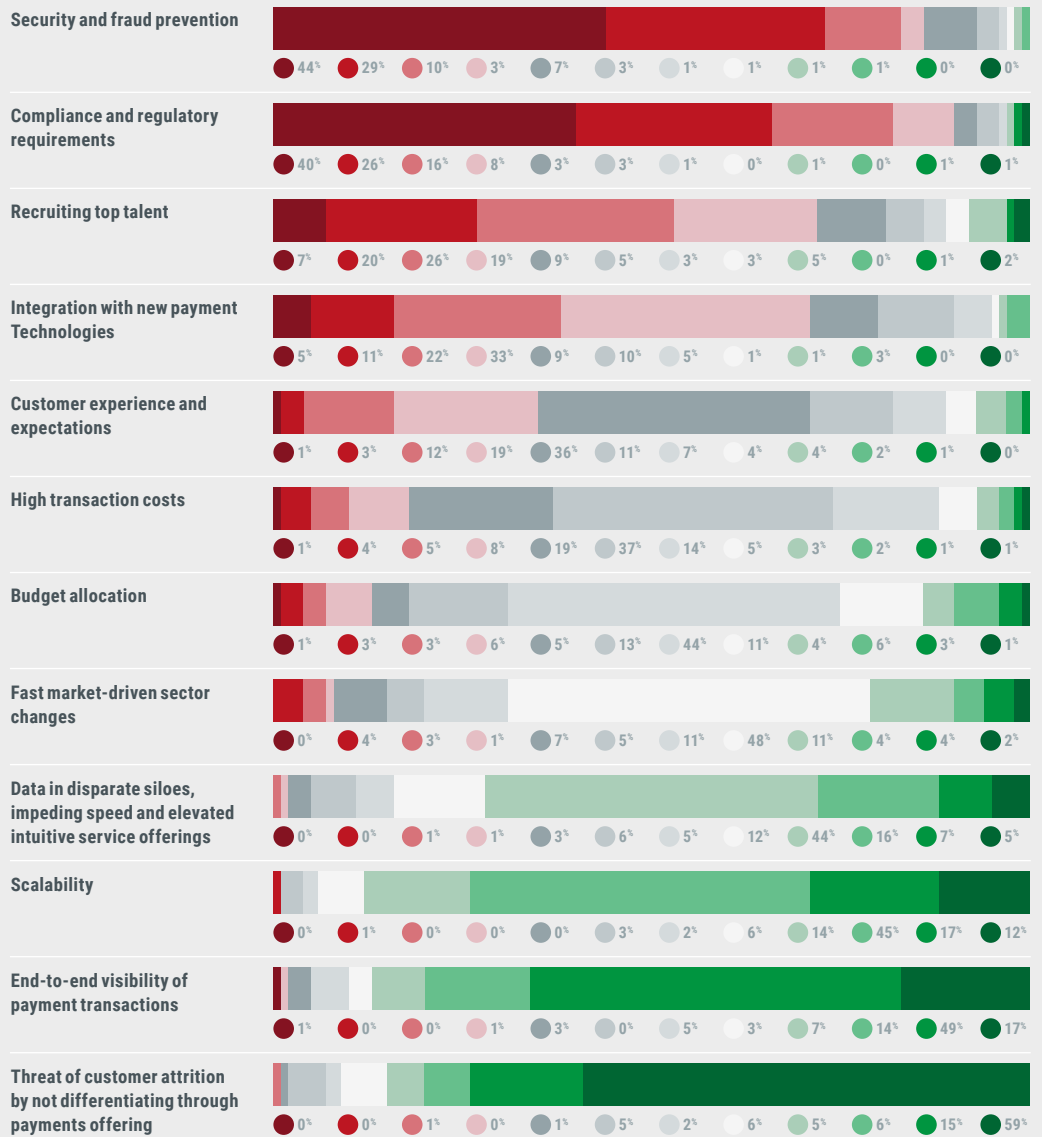
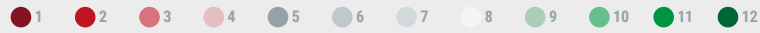
Banks tend to view fraud as a primary challenge, hence outsourcing this component may represent great risk for them. For the same reasons, there are perhaps not so many fraud outsourcing options on offer. Additionally, there are the volumes to consider and whether respondents are considering card fraud or non-card fraud, the former often being higher. It begs the question as to potential new market offerings of anti-fraud outsourcing solutions, and whether these would be available with an entire payments suite.

Customer service is also a popular component to outsource- the secondmost- almost two thirds selected this as an option.

Question 3

WHAT ARE THE PRIMARY CHALLENGES YOUR INSTITUTION FACES IN PAYMENT PROCESSING?

Rank in order, where 1 is greatest challenge



* Results may not total 100 due to rounding.

The top two challenges respondents listed in payments processing were Security and fraud prevention (73% ranking this first or second) and Compliance and regulatory requirements (66% ranking first or second). This speaks to the fact that fraud and KYC processes are the least likely components to be outsourced, as we saw and discussed previously, and suggests that organisations are really hampered by keeping the lights safely on, perhaps in light of increased pace of regulatory updates and mandates and increasing fraud threat, all within the context of a real time environment, legacy modernisation and the harnessing of new technologies. However, if banks felt more confident handing over the fraud component to a specialist provider, a non-bank, it could be a game-changer in being able to hone their unique service offering: to differentiate.

There may also be a lack of clarity as to responsibility and liability of outsourcing certain components. Regulations in Europe such as DORA (Digital Operational Resilience Act) and others will bring about a new collective responsibility for overall system resilience and security, and concerns about sharing or outsourcing such sensitive components as fraud operations may be alleviated when these reforms take hold. The changes reflect the shifting nature of the payments and banking industry, in that specialist partnerships now are seen as part of a foundational rubric of banking provision, and therefore will be regulated likewise. And these changes have really been made possible by the advent of cloud infrastructure.

The third greatest challenge- that of recruiting top talent is a much less urgent challenge than the top two- with only 27% ranking it in the top two, yet it could be taken as an indication of strategy to deal with the top challenges and it is likely to refer to technology talent. The likes of AI, for example, can alleviate major operational challenges and resource heavy activities by automating, but AI and top tech talent is hard to come by. In a sense, the act of outsourcing is a means of addressing the talent issue. Either way, it boils down to streamlining processes and fine-tuning resource in order to focus on the goals of the business.

Surely the number one focus for any bank would be the customer experience. A secure and resilient service is taken for granted by customers, and rightly so, therefore it is unlikely that organisations would actually choose to offload the customer experience over fraud management. This also depends on what they perceive to be the customer experience and whether it means simply the creation and delivery of products and services, or actual interaction, onboarding and lifetime management.

We can see here that issues such as siloed data deposits, scalability and fear of attrition as a result of a bland payments offering are not urgent problems for these banks. And yet these would be the kinds of elements that an organisation would certainly focus on to elevate and differentiate. Budget allocation for payment processing hovers just below halfway which, while good news, could indicate that there is a lack of coherent strategy in finetuning payments processing, and perhaps with greater expertise or tech talent, the choice of outsourcing might be different.

What we are also seeing is the current landscape for banks, what is right in front of them in terms of challenges and focus. Most organisations will adopt a stepwise approach to transformation and improvement and it would be interesting to chart a YOY progression, as attitudes and availability of market partners changes, as regulation supports new ways of operating, and as technology continues to shape offerings and propositions.

05

As-a-service models seen as means to enhance payments proposition but clarity is lacking around legacy integration

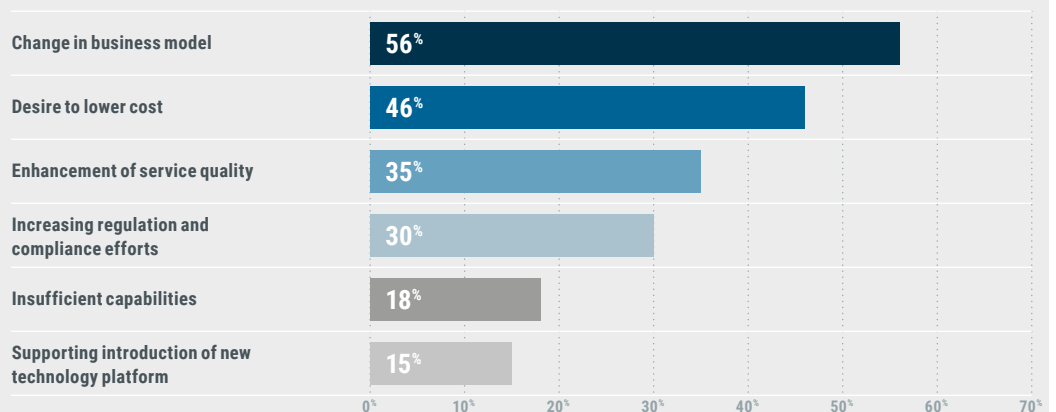
The greatest factor to cause a re-evaluation of operating model would be a change in business model, according to the respondents, with more than half selecting this (56%). Making payments a differentiator for those for whom it isn't would clearly impact operations, turning many current priorities and challenges on their heads.

When a bank decides to change its business model, it means that the institution is making significant adjustments to the way it conducts its operations, delivers services, and generates revenue. The data clearly shows that banks today are limited to the performance of their aged operating models.

Question 4

WHAT FACTOR(S) WOULD FORCE YOUR ORGANISATION TO RE-EVALUATE ITS OPERATING MODEL?

Select all that apply:



A desire to lower cost is the second key factor, pointing to an imperative to streamline and make their service more efficient.

Question 5

WHAT OPTION WOULD YOUR ORGANISATION CONSIDER TO ENHANCE ITS PAYMENTS CAPABILITIES?

Select option that is most true:

● Already in Planning or Implementation

● Most likely

● Undecided

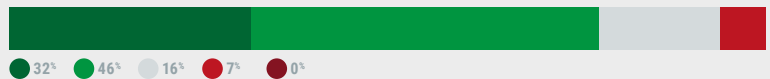
● Unlikely

● Definitely not for us

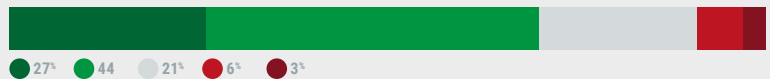
Creating an as-a-service model



Collaborating with other banks to create a common shared service



'Insourcing', whereby some payment capability is drawn from other organisations' capabilities



Captive outsourcing or creation of internal shared service



* Results may not total 100 due to rounding.

As-a-service models are the most popular option- these are also the most widespread and talked about models in the industry. These could be services offered by other banks or IT providers and the consideration and deliberation regarding which service provision to undertake will be significant. Fifty-two per cent state this option is the most likely choice for enhancing payments capabilities and it is the more likely choice than any other, given many organisations are still considering their options.

As we see in the next chart, cost efficiency, scalability and faster time to market for products and services drive the decision to adopt an As-a-service model, and responses to various questions have also made it clear that working with or drawing upon another banking organisation's payments capabilities is not the most sought after solution. Given the growing awareness and demand for As-a-service models, and current challenges likely attributed to the current use of other banks' services, these goals seem likely to be met.

As-a-service models represent for respondents an independent source of expertise that seems easiest to integrate with, and free of any technological legacy concerns of a peer institution. And perhaps also freedom and flexibility, to build and/or change outsourced components as a bank adopts a new business model, for example.

06

Tentative bets hedged on As-a-service models to streamline and scale operations at reduced cost

Modern (PaaS) providers can facilitate the processing on a modern platform with individual capabilities that can be leveraged alongside existing processing capabilities, for example, “hiring” PaaS for Instant Payments, while keeping batch and cross-border as-is.

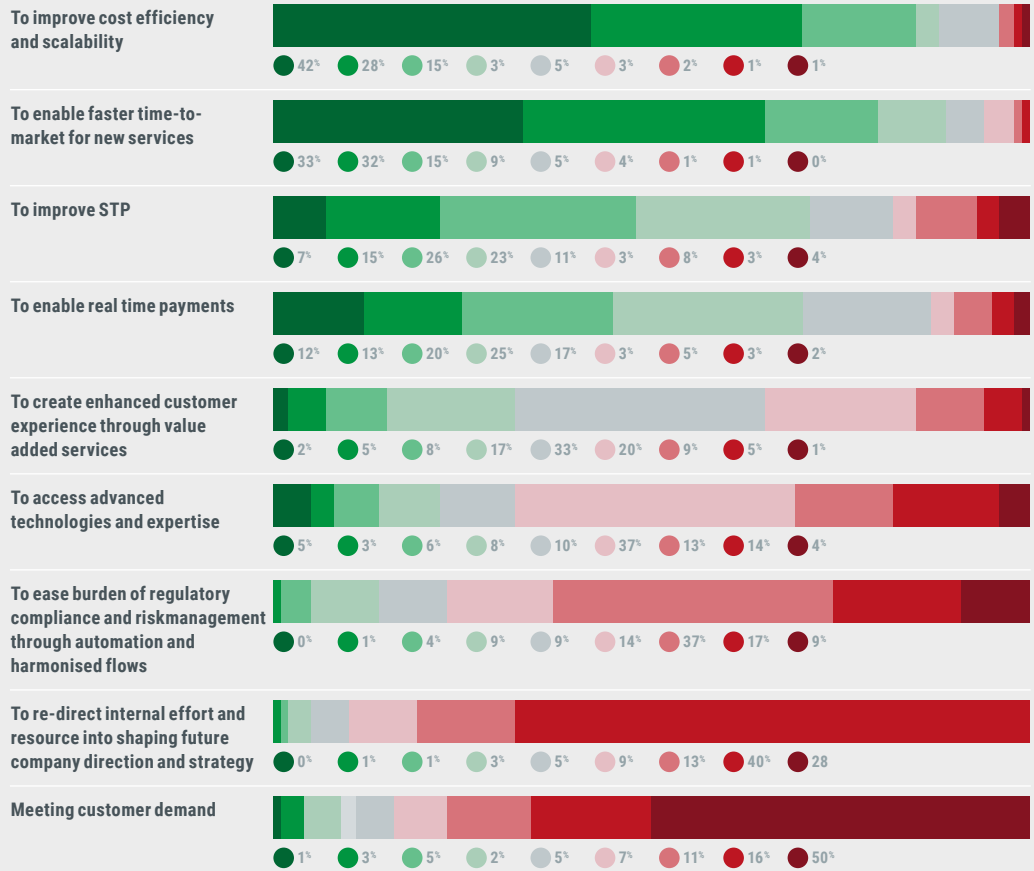
Example approaches to PaaS could be: instant payments PaaS and migration from batch to instant; cross-border on a modern platform, enabling alternative rails and improving cost / transaction as well as value for the end user (more rails for contingency and competitive rates, more currency corridors with low entry-barriers).

For the more holistic as-a-service model, the primary driver for respondents is the improvement of cost efficiency and scalability, followed by ‘enabling faster time to market for new services’. These two are quite pronounced frontrunners.

Question 6

WHICH OF THE FOLLOWING FACTORS IS THE PRIMARY DRIVER FOR CONSIDERING AN AS-A-SERVICE OPERATING MODEL?

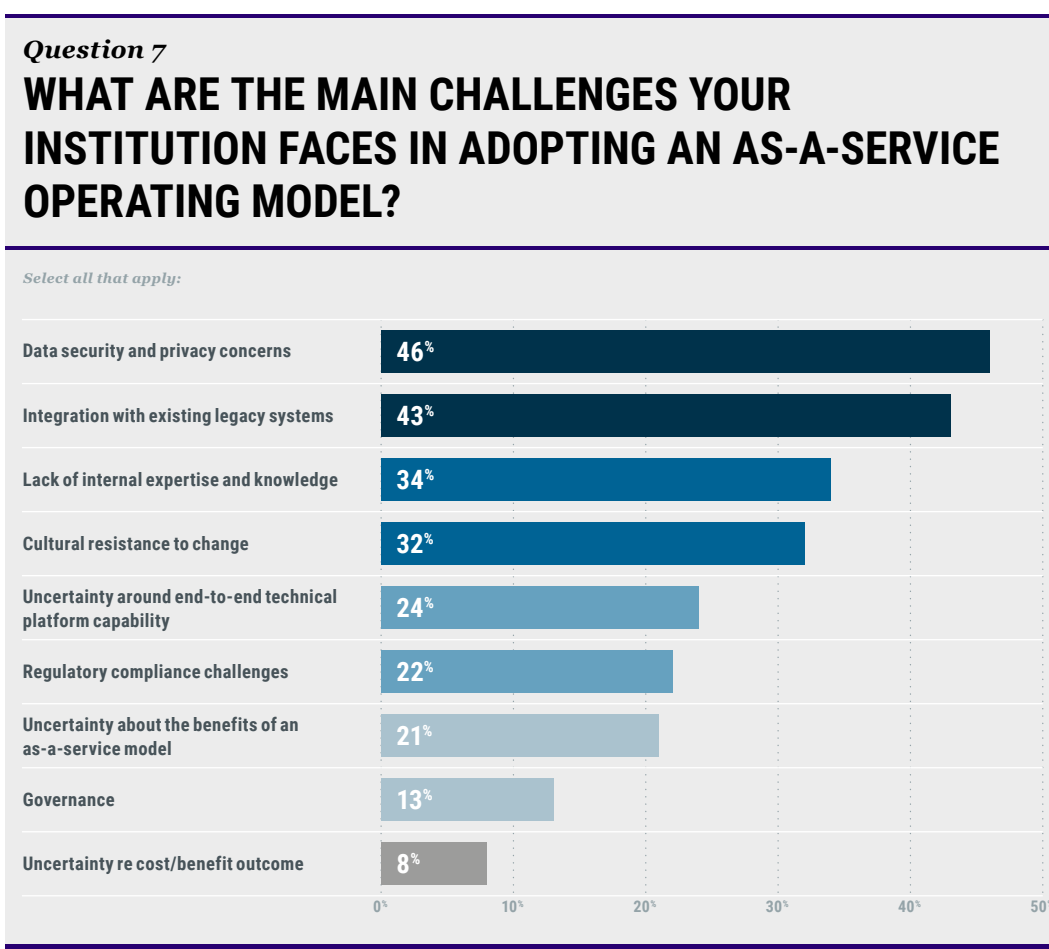
Please rank in order, where 1 is the greatest driver



* Results may not total 100 due to rounding.

There is a palpable understanding that a more comprehensive as-a-service offering would deliver greater overall benefit to the business- reducing costs, and being able to grow with better services created and delivered in a faster and more efficient timeframe.

Considering the following responses to the challenges perceived in adopting an as-a-service model, the immensity of the problem and solution is echoed in the fact that legacy integration concerns - particularly around data security and privacy - top the list. These are mammoth issues and no doubt many banks would already be opting for As-a-service models and the transformative benefits they could bring if they didn't have such pressing and major issues around their legacy systems.



Again, lack of internal expertise and knowledge ranks quite highly here too- it can be drawn that were there to be more confidence in internal expertise, there might not be a need or desire for a new model in the first place, nor the kinds of great challenges we are being shown here. Referring back to the challenge of recruitment, it points to the potential value of a holistic staffing and expertise function, along with or independent of any bought-in technology.

What's interesting to note is that uncertainty around benefits, platform capability and cost-benefit ratio hardly rank at all. So it's not so much whether to do it, or indeed why- just how.

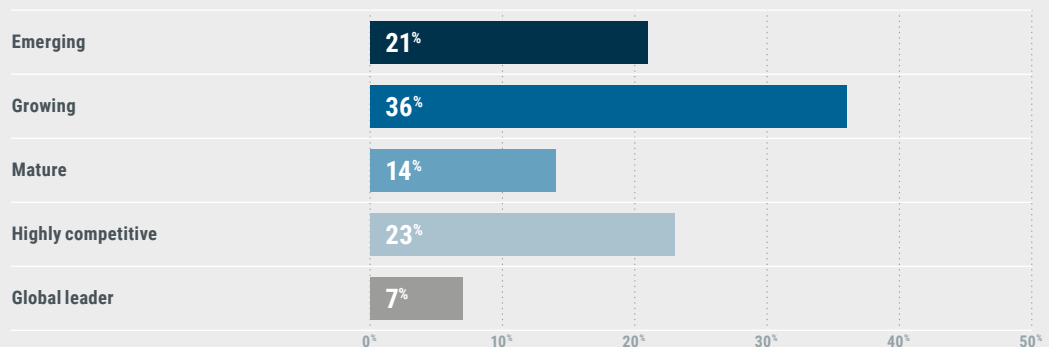
The following chart supports the above notions very much. Adoption of as-a-service models are perceived very much as growing. There is a sense of there being a point of inflection whereby the 'how' outlined above will be the final piece to work through before taking the plunge for many banks. There is clearly uncertainty around the different types and the various benefits of As-a-service models in the market.

Moreover, when banks are relying on capabilities from other legacy banks, there can be cumbersome integration challenges, opening greater opportunities for system risk- fraud or data privacy issues, etc.

Question 8

HOW WOULD YOU EVALUATE THE LEVEL OF MATURITY IN YOUR ORGANISATION'S DOMESTIC MARKET CONCERNING THE ADOPTION OF AN AS-A-SERVICE MODEL?

Select one:

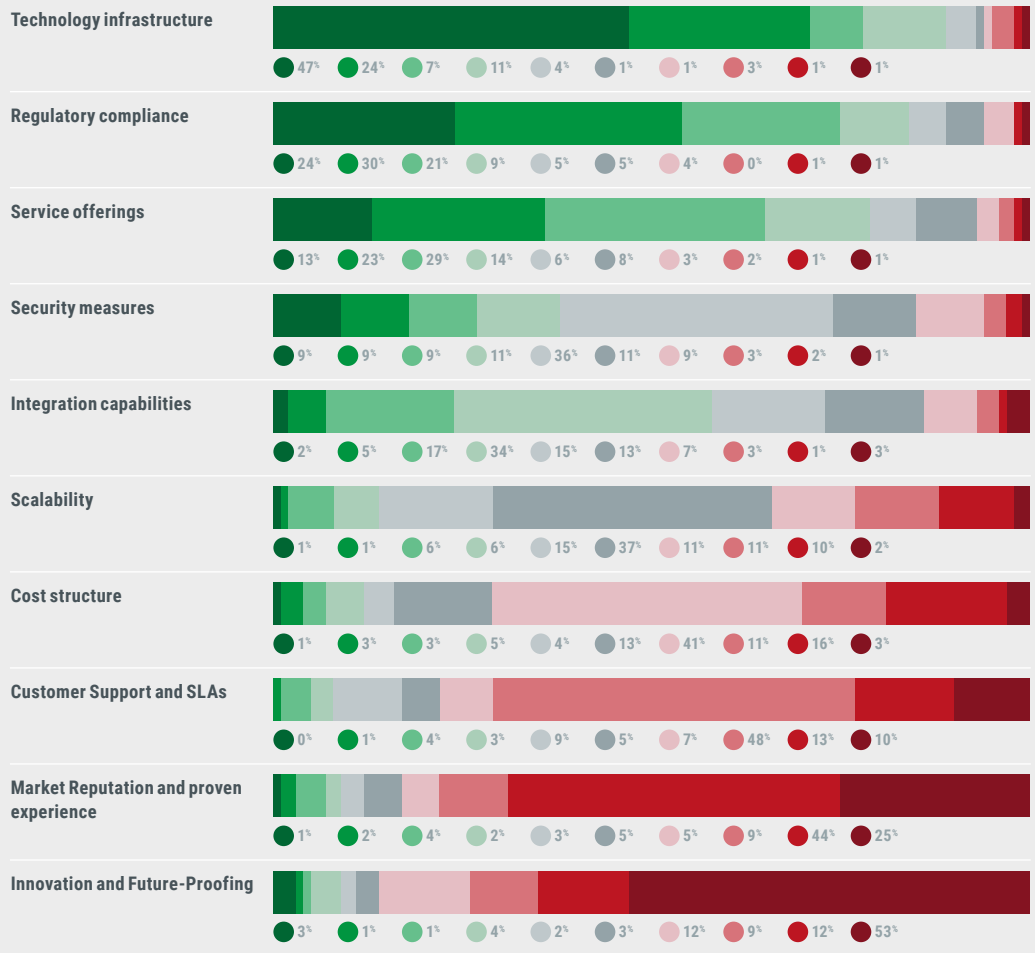
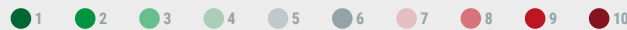


* Results may not total 100 due to rounding.

Question 9

PLEASE RANK THE FOLLOWING FACTORS IN ORDER OF IMPORTANCE WHEN EVALUATING A POTENTIAL VENDOR OR PARTNER FOR AN AS-A-SERVICE MODEL

Rank in order, where 1 is greatest importance



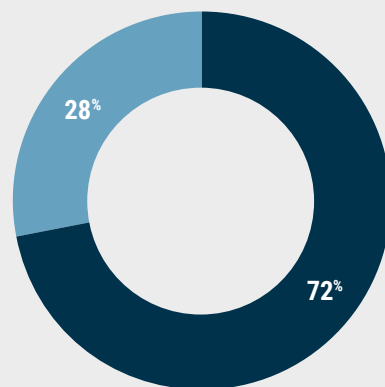
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The top answer here denotes a need for technical compatibility. A resounding 71% placed technology infrastructure top of the list of factors when evaluating a potential vendor or partner for an as-a-service model. Regulatory compliance is an interesting second place choice, highlighting the burden of compliance we saw earlier in the top challenges in payments processing (where compliance and regulatory compliance also came second). It also reinforces the legacy integration challenges as perceived by organisations, albeit respondents list integration capabilities about halfway down in order of priority for partner capabilities.

Banks clearly feel that the complexities of integration lies with themselves to navigate, as long as the technical infrastructure is a good match. This does reveal a potential lack of understanding of what a complete service can offer, and what it entails. Regardless, it is clear what a relief and benefit it would be to offload major components to a trusted third party partner. Service offerings comes in third place and to a point, the rest falls into place once the big boxes are ticked.

Question 10

PLEASE SELECT ONE OF THE FOLLOWING STATEMENTS TO SUMMARISE YOUR PERCEPTION OF AN AS-A-SERVICE MODEL



- A payments service should be a holistic endeavour, encompassing IT and fraud operations in order to maximise the capability, sidestep legacy constraints and fast-track differentiation
- A payments service should take a minimalist or piecemeal approach whereby certain components may be offloaded, and potentially others in the future, but where the resource and IT remains fundamentally under the remit of the organisation

Here, the intentions and ambitions are marked: banks and institutions want to go above and beyond in their payments offering, delivering a unique and competitive service. There are of course several ways in which to achieve this and it is clear that organisations are grappling with the intricacies of carving out a sensible approach while maintaining cumbersome and costly legacy components. Some responses reveal an apparent disconnect between what they feel they should control and manage themselves in order to achieve their goals and how they view different outsourcing options and models. But what is palpably clear is that they are resolute about partnering in order to expedite plans, development and growth, the industry is on the precipice of a major upward curve in accelerating these trajectories, they are just at the final deliberation stages of charting their course and choosing the pathway.

07

About

Finextra

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