2017 Global Payments Insight Survey: Retail Banking

Catalyst

Payment players need to rethink roles and relationships

The payments market is changing. Across the value chain, organizations are investing in technology as they try to adjust to a shifting market. Both existing and new players are now creating new payments models and, in the process, upending existing business paradigms. Market participants now have to create new strategies to address the changes occurring and seize the opportunity these payment shifts are bringing.

Critical to forming an effective payments strategy is understanding how the forces at play in the industry affect all corners of the value chain. Organizations of all types must understand how these changes fit in with existing payments capabilities and business priorities.

Starting in 2015, technology analyst house Ovum, in conjunction with ACI Worldwide, has conducted the annual Ovum Global Payments Insight Survey. This global survey of merchants, retail banks and billing organizations examines strategic plans and IT investment trends, asking respondents about their experiences, perceptions and expectations of payments and how this is shaping their investment and development activity.

This report examines the challenges and opportunities facing retail banks, and highlights the key findings from the third year of this research program. It provides an analysis of how the immediate challenges of today's regulatory and competitive landscape are driving investment to deliver on the requirements of financial institutions for both the short and long-term. It is one part of a four-part series based on Ovum's 2017 survey. Those interested in the research focusing on merchants, billing organizations and the cross-vertical global overview should visit
www.aciworldwide.com/paymentsinsight
for further information.

Summary

Retail banking is a sector under pressure when it comes to delivering – and profiting from – payment services. Regulatory change, the sustained growth in scale of what were new entrants in the recent past, and rapid change in both consumer and merchant behavior are all creating pressure on existing bank products, services, and the underlying technology stack.

Set against a background of budgetary constraints and the need to manage what is often a complex legacy environment, many institutions are faced with difficult decisions about how to prioritize their IT investments.

This report examines these issues, drawing on the results of Ovum's 2017 Payment Insights Survey. Key findings include:

- 57% of all banks are growing their IT investments in 2017, up from 53% in 2016.
- Activity will be strongest in Europe, where 62% of institutions are increasing budgets for payments-related projects.
- Delivering increased operational efficiency is the biggest single ROI expected from these investments, and is a priority for 91% of banks.

Perhaps unsurprisingly, given the broader operating environment, institutions are balancing this increased investment across projects aimed at reducing the risk of fraud and financial crime, and those with the direct purpose of delivering new products and services to customers.

- 68% of banks have recently, or are currently, investing in their fraud detection and prevention capabilities.
- At the same time, 67% have or are working on projects around online payments.
- 46% plan future projects to enhance their payment switch and related architecture.

With most major markets either live with immediate payments (IP) infrastructure or with a clear roadmap, attitudes towards the benefits IP can deliver are increasingly positive.

- 61% of banks believe that immediate payments will enhance their service and proposition to customers.
- 60% of banks also expect IP to reduce their costs, as the necessary improvements to payment infrastructure and fraud systems deliver broader benefit to the institution.
- 66% of banks in markets with live IP view this as a revenue driver for their institution.

Open APIs remain one of the hottest topics in the industry, with many banks positive about the impact that the ability to support a new wave of innovative services and customer experiences will have on their business.

- 65% of institutions believe that APIs open to third party developers will benefit their customer-facing proposition.
- However, while 59% have a clear strategy for creating open APIs and interfaces for developers, 45% also report that they are taking a 'wait and see' approach.
- Concerns about security remain a challenge for 42% of institutions, undoubtedly driven by concern over the reputational and customer impact of possible data breach and fraudulent use.

Recommendations

Despite the global nature of the factors driving change in the payments industry, the impact on individual institutions will depend on their specific market challenges, existing technology stack, wider business strategy and development roadmap. Nevertheless, the findings in this study highlight some important steps that all retail banks should consider to ensure that they are prepared to take advantage of the opportunities presented by this period of change.

- **Retail banks should view their payments infrastructure as the key to future front-office product development, and invest accordingly.** The pace of change in the payments industry, across all areas of the customer base, is rapid and will necessitate continued investment in order to remain competitive. In particular, investments in core platforms and infrastructure will provide the foundation for greater agility and innovation in future product development.

- **Learn the lessons from today's live immediate payments deployments.** Institutions in markets that are actively moving towards immediate payments infrastructure, or have a clear roadmap to do so, should learn the lessons from existing deployments. Ensure that new overlay propositions and improvements to existing services are top of mind, particularly in the SME space. At the same time, banks should take the opportunity to reduce legacy technology and add further capabilities when investing in the solutions needed to deliver immediate payments to customers.

- **Take an active approach to the opportunities presented by open APIs and related initiatives.** At a global level, the market is split between those banks actively exploring open APIs for third parties and those that are taking a watching brief. While there are advantages in being a late-mover, there are also real risks in being slow to market with new services and propositions that support customer demand to consumer their financial information and services through third parties. The market will move quickly and there will be few prizes for second place; developing a strategy and roadmap for open APIs is essential.

- **Ensure that security investments support increased customer functionality, as well as better management of risk.** The growing fraud threat and rising sophistication of cyber-attacks on financial institutions (and their customers) has ensured that investments to improve transaction authentication and fraud detection are high on the agenda. When making these investments, every opportunity should be taken to simultaneously improve the customer experience. Indeed, the implementation of immediate payments infrastructure and moving towards open APIs are key opportunities to improve the balance between fraud risk and a friction-free user experience.

Investing to enhance security and deliver new infrastructure will drive growth in 2017

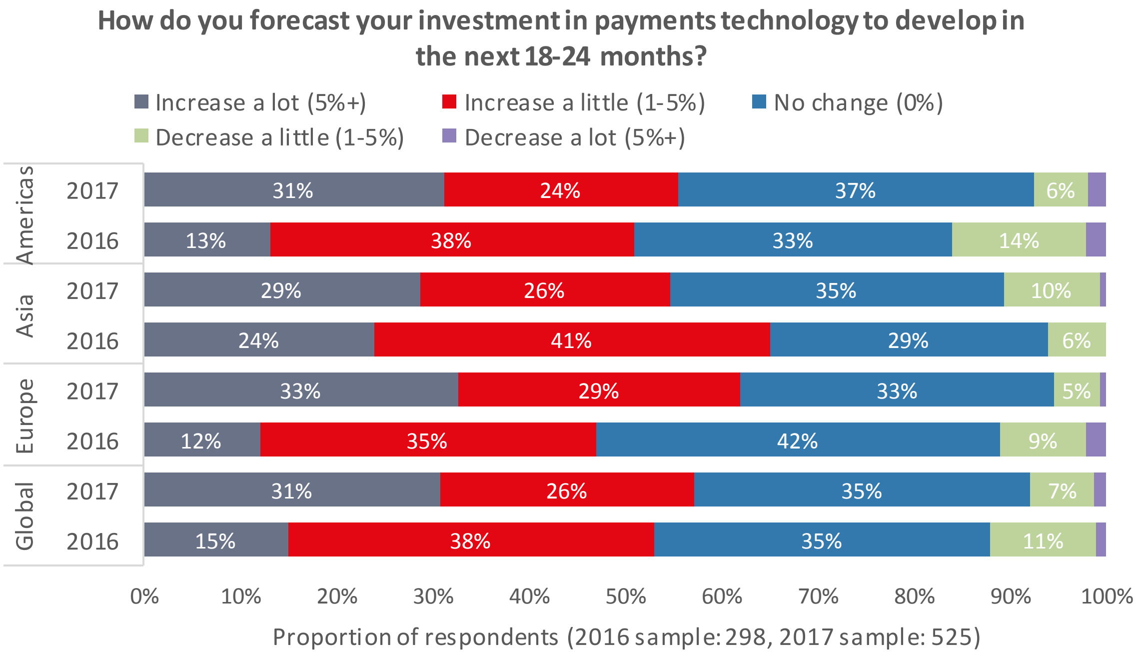
Retail banks will be investing heavily in 2017 in their payments capabilities, to ensure compliance and deliver new services

The need to address the challenges facing the industry is seeing many retail banks invest heavily to deliver new and enhanced payments capabilities. Across all territories and regions, 57% of banks will be growing their investment in software and services in 2017. This is up from 53% in 2016 and, in many cases, reflects sustained year-on-year growth in order to meet increasing customer expectations and competitive challenges.

Within this, the proportion of institutions that are seeing relatively rapid growth in their investment in payments technology is also increasing. Just under a third of banks (31%) will increase their payments IT spend by 5% or more, up from 15% in 2016. Conversely, fewer than 8% are looking to reduce expenditure. In many cases this is due to M&A or following high investment levels in prior years.

Activity will be strongest in Europe with 62% of institutions increasing payments IT budgets and 33% increasing investment by 5% or more. This is a marked change on 2016 when European banks lagged behind those in Asia and the Americas, and reflects the need for European banks to remain competitive while delivering immediate payments and regulator-mandated open API initiatives.

Figure 1: Over half of all banks will grow their spending on payments technology in 2017, with 31% increasing investment by more than 5%



Source: 2017 Ovum Global Payments Insight Survey

While the specific drivers of this increased investment will vary by institution and the competitive and regulatory context each faces, there are some strong themes that emerge when considering the expected return on additional payments IT investment.

Delivering increased operational efficiency is the single most important outcome for retail banks, with 91% listing this as a main objective. While this is inextricably linked to the customer experience in practice, it also highlights the need among almost all banks to manage and replace their legacy IT infrastructure.

Reducing operating cost is also key here and is a specific requirement for 71% of institutions globally (76% in Asia). With 53% of banks reporting that the operating costs of their payments business have increased since 2014, this is perhaps not surprising.

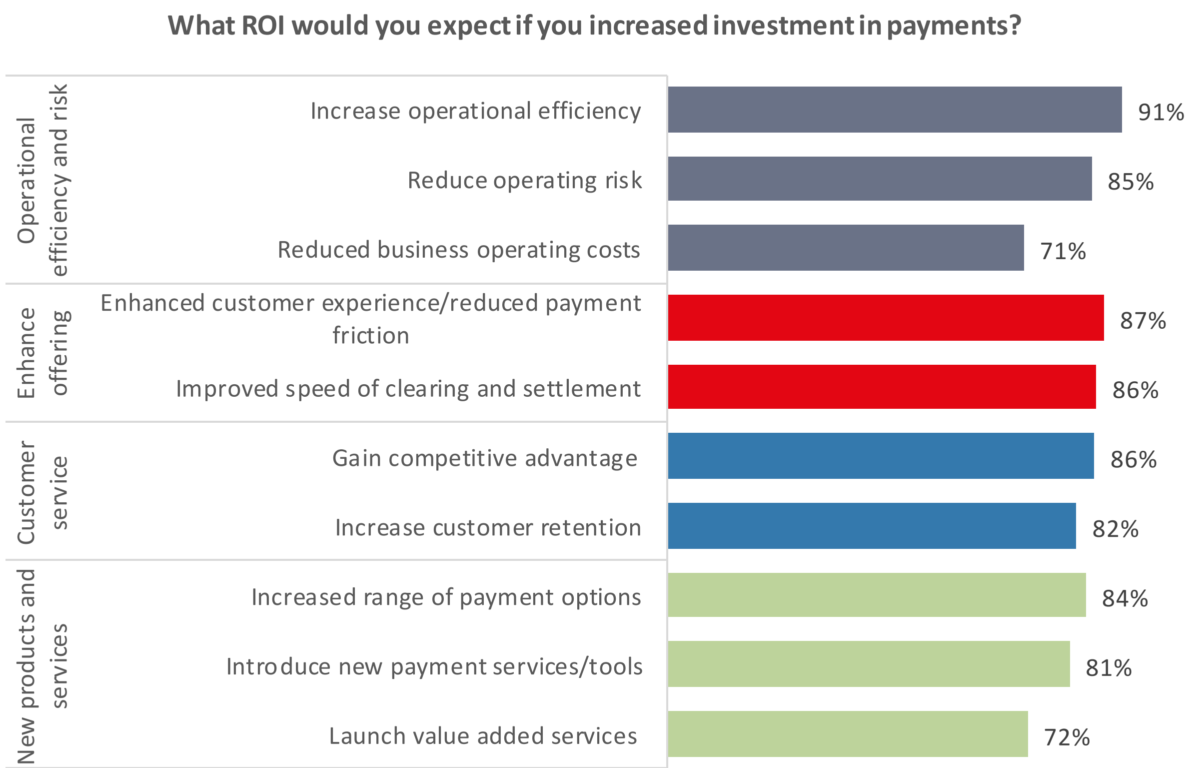
Delivering an enhanced end-user payment experience, specifically in reducing payment friction, is the most important product-level priority and was cited by 87% of banks. Banks in Asia place a slightly higher emphasis here, with 90% focusing on this objective.

Linked to this is improving the speed of clearing and settlement (a priority for 86%), and increasing the range of payment options (84%).

At a regional level, banks in Europe are most heavily focused on bringing new products to market. Across the region, 86% are targeting the introduction of new payment tools to customers, compared to 81% at a global level.

In the Americas, there is a greater emphasis on delivering value-added services, with 76% investing to deliver new capabilities here.

Figure 2: Driving revenue growth from new products and services is the overarching priority for banks in all regions



Source: 2017 Ovum Global Payments Insight Survey

Investments in security and compliance, alongside new propositions in online and mobile, are top of mind for banks

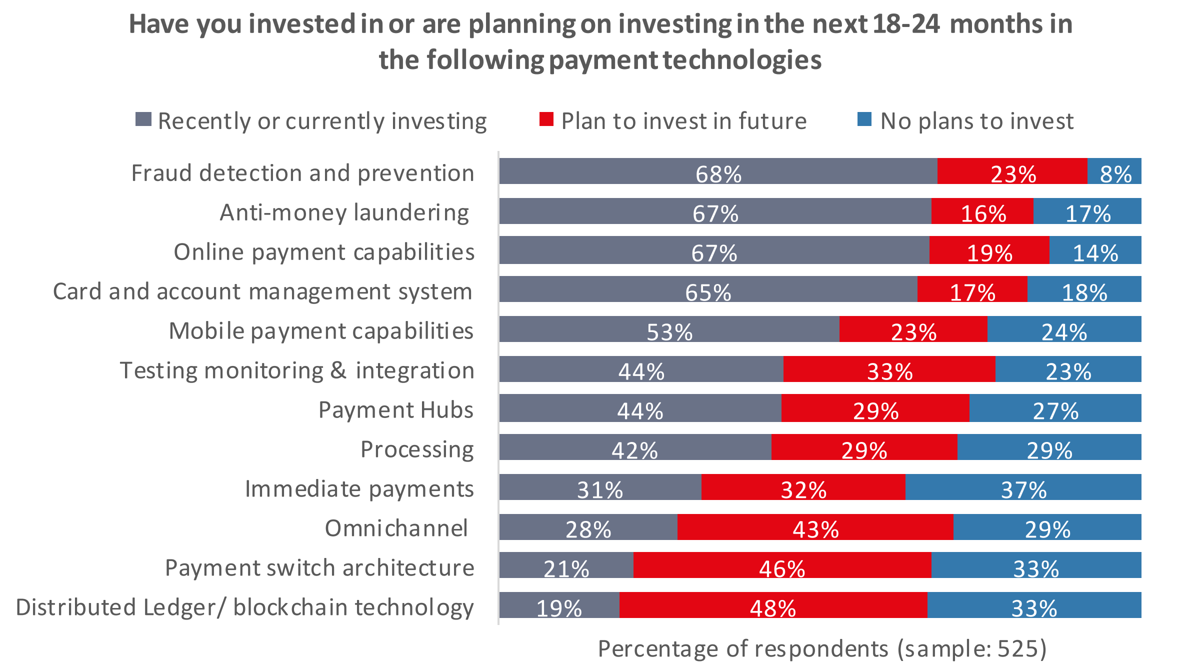
Perhaps unsurprisingly, investments in solutions to reduce the risk of fraud and financial crime are top of the agenda for banks. Fraud detection and prevention is an area in which 68% of banks have recently or are currently investing, with a further 23% planning future projects. At the same time, regulatory change around anti-money laundering has driven activity here, with 67% recently or currently expanding capabilities.

Enhancements to authentication and fraud detection are also integral to delivering new payment services, and will be a priority for those banks working on projects around the second Payment Services Directive (PSD2).

Alongside security, direct investments in new retail payment services remain a core focus. Online payment capabilities, particularly around digital wallets and tokenization, are clear priorities. At a global level, 67% of banks have or are investing in new online payment propositions, while 65% are focusing on projects around the card management platform; in many cases to support digital payment initiatives.

Looking further ahead, the biggest themes for future investment are distributed ledger technology, and payment switch architecture. The former is an area of huge interest among banks, with 48% reporting they plan future investments, and many running internal proof of concepts (in many cases working with vendors or industry consortia). In the case of switch architecture, the rollout of immediate payments is the most important driver of investment.

Figure 3: Fraud and compliance are the biggest investment areas at the product level, with retail payments also top of mind



Source: 2017 Ovum Global Payments Insight Survey

Banks that have made steps to modernize their architecture appear to be enjoying the benefits of lower operating costs

As noted earlier, 91% of banks expect to deliver operational efficiency gains from investments in their payments infrastructure. Reassuringly, there are signs that this is being borne out in practice.

Figure 4 shows what has happened to the operating costs of each bank's payment business versus the proportion of commercial off-the-shelf solutions (COTS, packaged applications with little or no customization), more heavily customized 3rd party software, and bespoke solutions making up each institution's overall payment infrastructure.

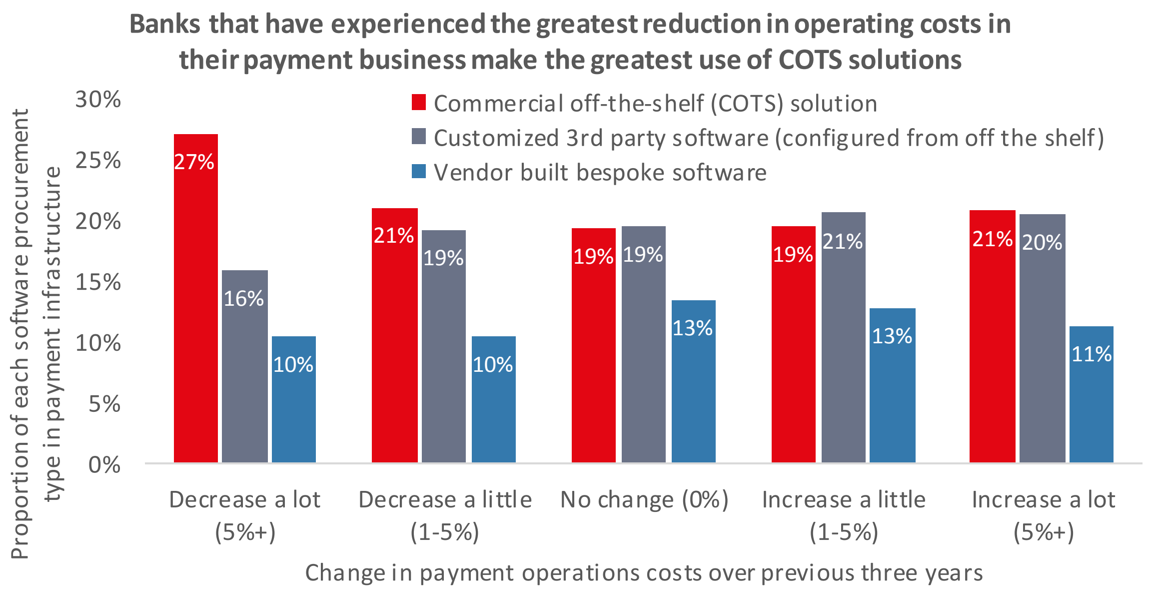
The picture is a complex one as, in practice, almost all banks manage a blend of legacy, custom, and packaged software. However, what is clear is that those banks with the highest proportion of COTS have experienced the greatest cost reductions.

At a global level, those banks that have enjoyed a cost reduction of 5% or more since 2014 run with 27% of COTS in their software stack and 16% customized third party software. Institutions that have seen costs increase by more than 5% report a split of 21% COTS and 20% customized software.

While this masks a huge amount of detail and complexity (namely what functions and systems sit in each area), it does demonstrate the efficiency gains which can be delivered from today's modern vendor solutions.

Despite the focus on SaaS from the vendor community, this remains relatively niche. At a global level, banks report that 8% of their payments software stack in production is consumed on this basis. At the same time, around 28% of the architecture for banks remains in-house developed.

Figure 4: Those banks that have migrated to modern platforms have seen their operating costs reduce over the past three years



Source: 2017 Ovum Global Payments Insight Survey

As immediate payment infrastructure spreads, banks are viewing this with increasing optimism

Immediate payment infrastructure is now being viewed by banks as an important revenue opportunity

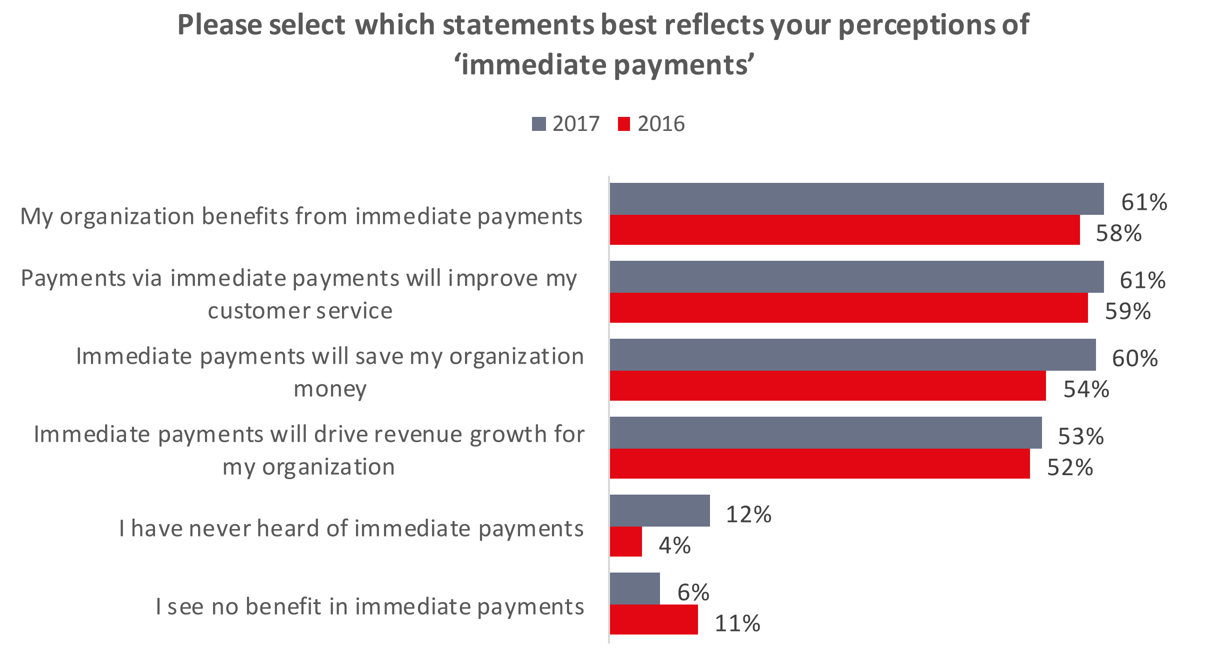
With most major markets either live with immediate payments (IP) infrastructure or with a clear roadmap, attitudes towards the benefits IP can deliver are increasingly positive. Only a small minority believe that IP offers no benefits to their institution.

Comparing the survey results from the 2016 and 2017 surveys, it is clear that thinking around the benefits of IP is beginning to take shape. At a global level, 61% of banks believe IP will enhance the ability of their institution to serve its customers, a slight improvement on the prior year but reflecting the greater understanding of IP that many banks now have. This is particularly true in the Americas, where 64% hold this view.

The proportion of banks who view IP as helping to drive cost reduction is also noteworthy, increasing from 54% to 60%. With many banks taking the opportunity to upgrade and enhance their broader architecture (particularly around payment hubs and orchestration layers), this shouldn't be a surprise. Also the ability of effective digital banking and overlay to reduce branch and contact center volumes, not to mention paper processing, is an important benefit; especially so in the SME sector.

The growing positivity around IP has seen the proportion who see no benefit in IP has fallen from 11% to 6%. In Europe, on the threshold of the SEPA Inst project, this level is 5%.

Figure 5: Immediate payments are seen as a clear opportunity to deliver new value to customers



Source: 2017 Ovum Global Payments Insight Survey

The lessons from markets with live solutions should be heeded by those markets moving towards launch

There are some important differences in perspectives around IP at country level depending on the current position with respect to IP infrastructure.

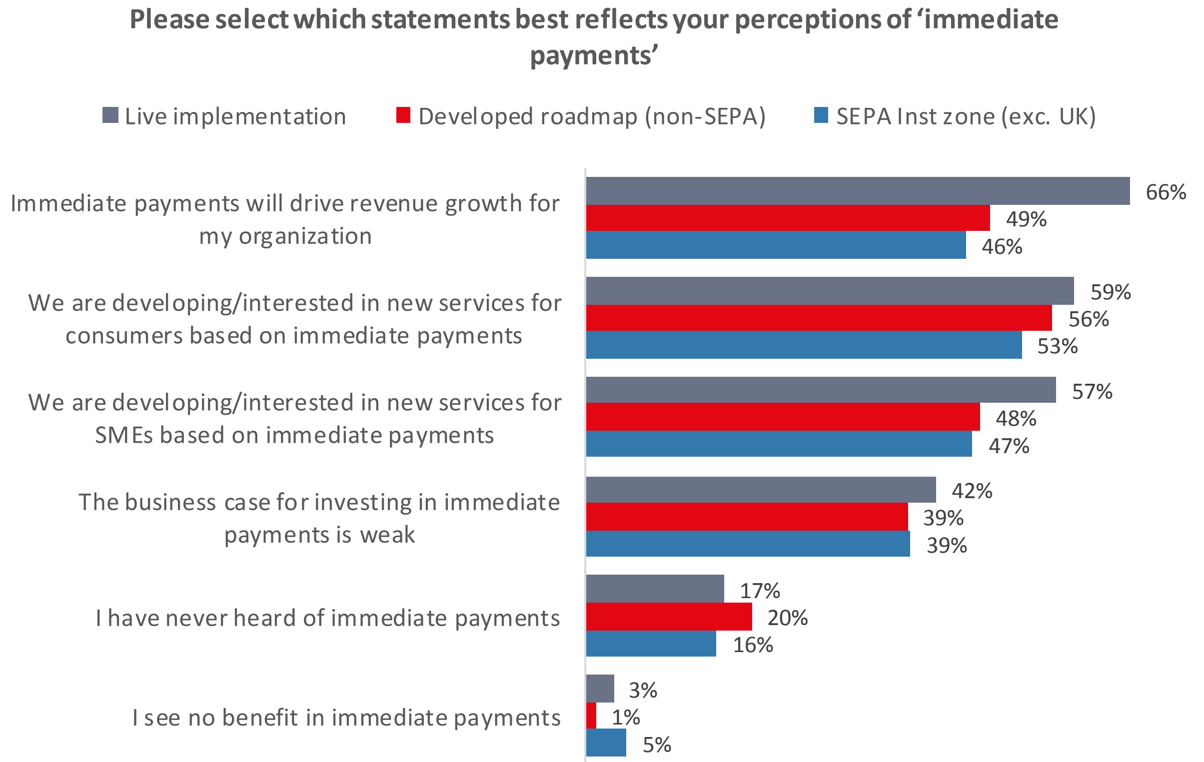
Banks in those markets with live deployments are more likely to see (or be experiencing) revenue growth opportunities from IP. This is a view shared by 66% of institutions in these markets, compared to 49% of those with a developed roadmap outside of the SCT Inst project and just 46% of those within it.

A large part of this is the relative maturity of the service enhancements which have been delivered in these markets, perhaps also alongside the familiarity of retail and commercial customers in making payments across these rails.

Indeed, while there is a strong focus on leveraging IP for new or enhanced retail offerings in all segments, the SME space should not be forgotten. Indeed, 57% of banks in markets with a live IP deployment are developing services for this customer group, compared to around 48% of those in markets that are moving towards deployment.

Interestingly around 40% of all banks believe the business case for IP is weak, perhaps explaining why these initiatives tend to be regulator mandated.

Figure 6: Banks in markets with live IP infrastructures are more overtly positive about the revenue impact, targeting added value services at both consumers and SMEs



Source: 2017 Ovum Global Payments Insight Survey

Banks expect benefits from their investments in fraud prevention, as well as enhanced liquidity management

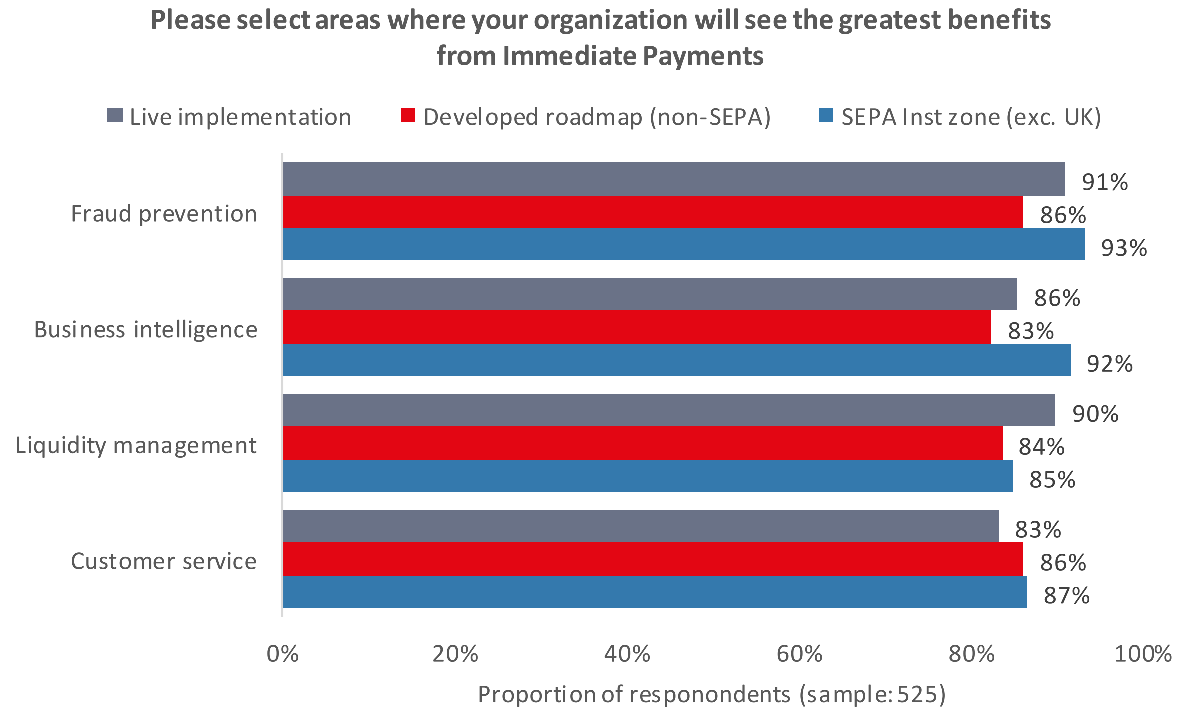
The need for banks to invest in new and enhanced capabilities across a range of functions in order to deliver IP is something that is delivering gains across the payment software stack for many institutions.

Enhancements to fraud prevention are seen as one of the most important outcomes, with 93% of the banks involved in SCT Inst citing this as a clear area of benefit. This is a view supported by those in markets with live deployments (91%), and is driven by the investments made to secure IP.

Liquidity management is also seen as an important benefit to the institution, particularly those with large bases of SME and corporate customers. Indeed, 90% of banks from markets with live IP infrastructure have enjoyed benefits here, although this is a space that slightly fewer banks in other markets are considering.

When it comes to customer service, there are higher expectations of the impact of IP among banks that are readying to launch, than the experience of those live with IP supports. 87% of banks in the SCT Inst zone and 86% of those in other markets with a developed roadmap for IP expect to see benefits here, while the experience of those in markets with live IP infrastructure is slightly lower (83%). This reflects that fact that it is new products and services on top of IP that generate the benefits rather than the technology itself.

Figure 7: The ability to deliver better fraud prevention and liquidity management services is expected to be a key benefit from implementing immediate payments



Source: 2017 Ovum Global Payments Insight Survey

Open APIs have the potential to re-shape the value chain and banks are making their plans

Whether regulator-mandated or not, many banks are making strategic decisions around open APIs

While the biggest moves towards creating APIs and other interfaces for third party developers are largely driven by regulators, there are signs that institutions in all regions are planning to embrace the opportunities in what will become a re-shaped value chain.

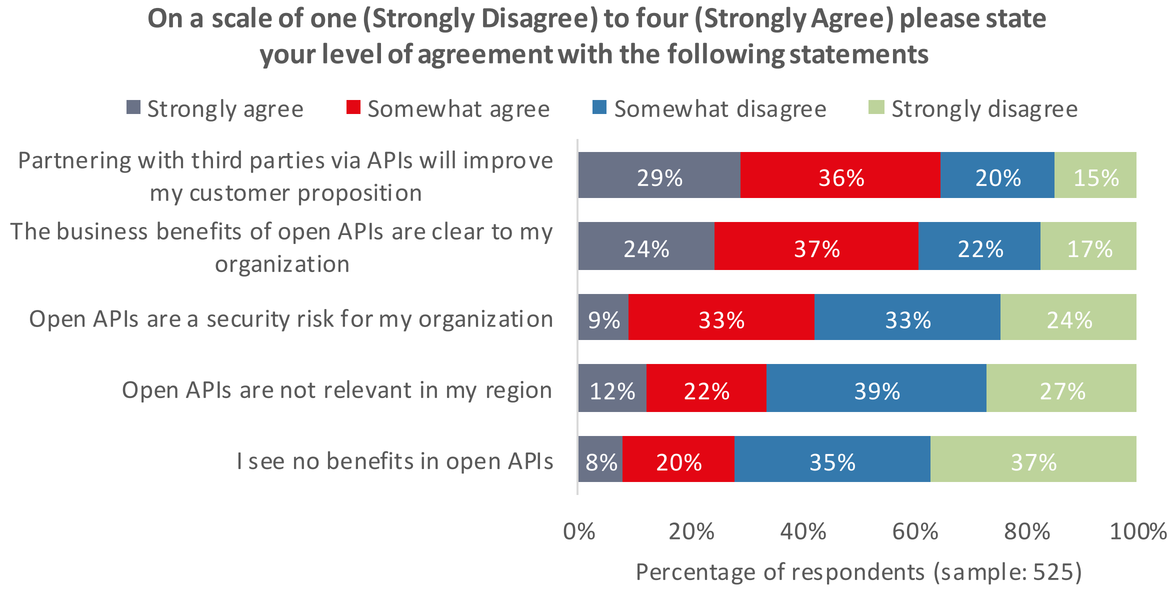
At a global level, 65% of banks believe that the ability to more easily partner with third parties – or become a part of a third party's customer journey – would benefit their proposition. This view is particularly strong in Europe (69%), where the deadline for PSD2 compliance is fast approaching.

Perspectives on the wider benefits from this approach are also positive. At a global level, 61% see clear business benefits to their organization, a view slightly stronger in Asia (63%), where many banks are looking at Europe and planning their own strategies based on what emerges as best practice.

A large minority (28%) do view open APIs as offering no benefits, a position that is slightly more popular among those banks in Europe delivering against a regulatory mandate, with 31% taking this position. This divergence in view suggests that open APIs and support for developers will become strong competitive differentiators in the future.

Security remains an important issue, and is a concern for 42% of banks. Within this, data security is a particularly important concern.

Figure 8: Attitudes towards open APIs are positive across banks in all regions and territories, although security concerns remain important for a large minority



Source: 2017 Ovum Global Payments Insight Survey

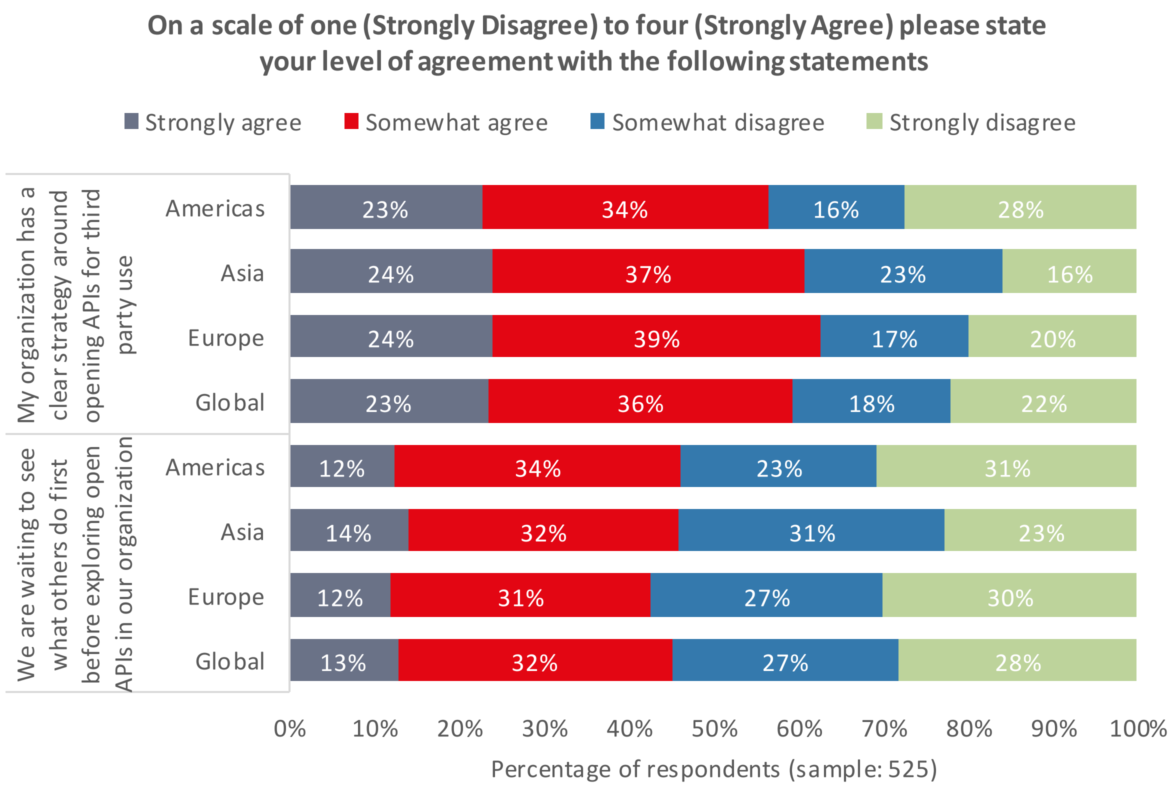
Nevertheless, a large proportion of banks are taking a 'wait and see approach'

Despite the degree to which open APIs and related issues have led the debate in the industry, and particularly that this is being driven by regulatory mandate in many markets, a large proportion of banks are taking a watching brief when it comes to their own open API strategy.

At a global level, 45% of banks report that they are waiting to see what other banks do before deciding on their strategy. For those banks outside Europe, the ability to be fast followers and learn from the inevitable missteps and errors, may be beneficial. However, 43% of those in Europe are also taking this approach. While there are banks who are deliberately making slow progress, given PSD2 will be enforced by domestic competent authorities in each country, it must be assumed that the majority of this 43% of institutions is referring to broader initiatives beyond PSD2 compliance.

At the same time, 59% of banks have a clear strategy for opening APIs for third party developers. This level is broadly consistent globally, but those in Europe are slightly more advanced (63%). While the market will watch Europe closely, the reshaping of the ecosystem driven by open APIs will be a global phenomenon.

Figure 8: There is a clear split in the industry, between those banks with a clear open API strategy, and those deciding to see how successful the early movers become



Source: 2017 Ovum Global Payments Insight Survey

Appendix

Methodology

For the 2017 Ovum Global Payment Information Survey, ACI and Ovum created a 23 point questionnaire, looking at the following for key payment players:

- Significant aspects of existing payments infrastructure
- Forecasts for spending
- Areas for investment
- Perceptions of where payments fit within their broader strategic objectives

This survey was run with a panel of payments decision makers globally in December - January 2016/17, providing a snapshot of payment perceptions amongst financial institutions, merchants, scheduled payment-taking organizations such as higher education, consumer finance and insurance.

Overall, this included a total 1,475 executive respondents across 13 industry sub verticals in 18 key global markets, resulting in over 197,000 separate data points on perceptions and expectations of payments amongst critical payment enablers globally.

Respondent Breakdown	
Total Respondents	525
Respondents by Region	
Americas	42.9%
EMEA	28.6%
Asia Pacific	28.6%
Sub-verticals surveyed	
Financial Institutions	
Retail banking	
Merchant acquiring	
Example Respondent Titles	
CIO, IT Director, Global Head of Payments, Head of Operations, Head of Retail etc.	

This report focuses on the retail banking survey, and is based on the insights from the 525 respondents interviewed.

Those interested in finding out more detail about a global cross-industry view, or the individual views at the billing organization and retailer level are advised to visit https://www.aciworldwide.com/retailbankinginsights for further information.

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We hope that this analysis will help you make informed and imaginative business decisions. If you have further requirements, Ovum's consulting team may be able to help you. For more information about Ovum's consulting capabilities, please contact us directly at consulting@ovum.com.

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