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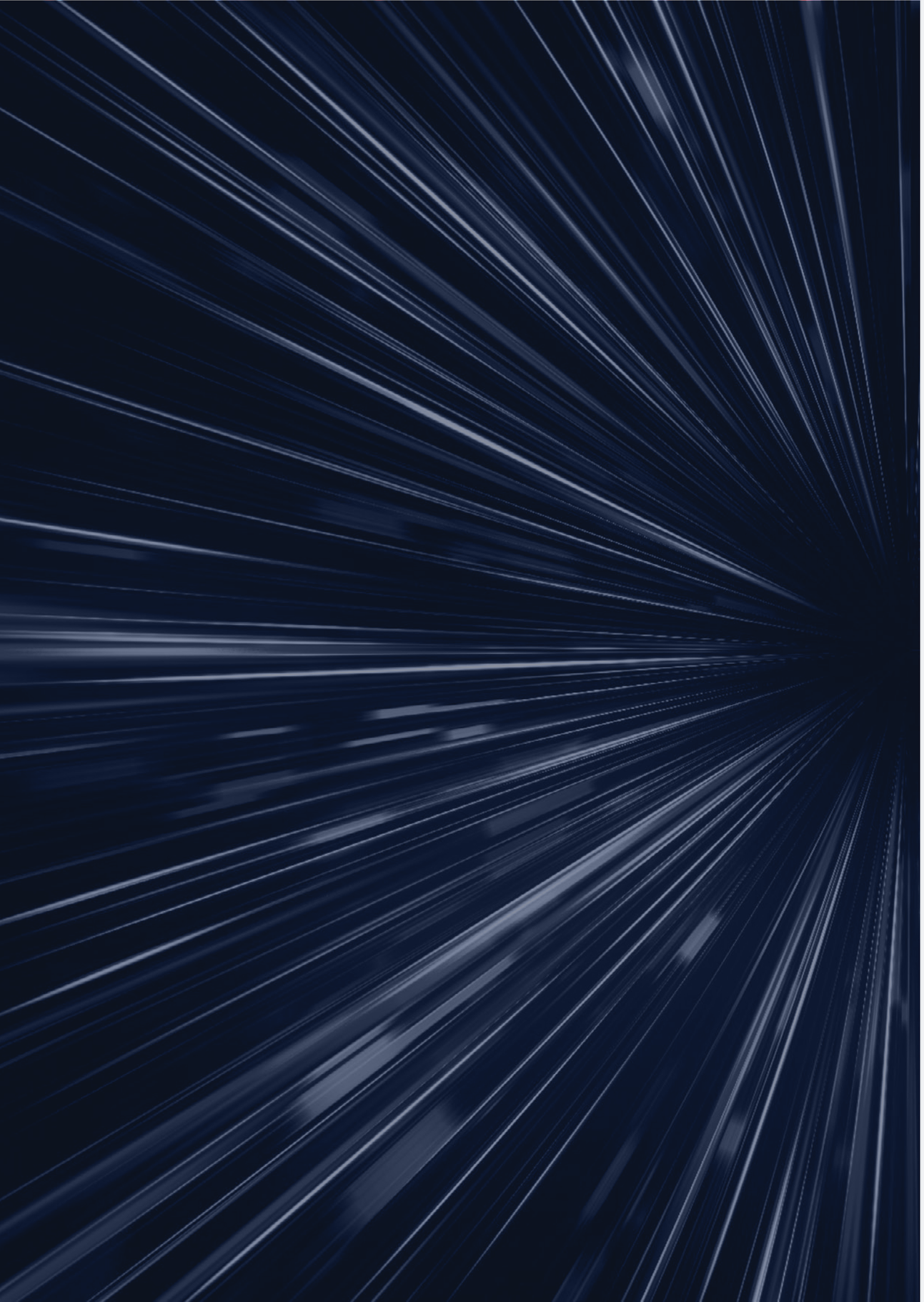
The payments extinction event

What's next after the death of legacy infrastructure?

Written by Karl Smith and Brian Hanrahan



Introduction

From high costs to inefficient processes, the shortcomings of legacy payments are becoming clearer by the day.

Today's customers are more focused than ever on accessing smooth experiences and real-time payments. Businesses, meanwhile, are seeking to harness payment methods that are optimised for the subscription economy.

With that in mind, it's no surprise that real-time account-to-account (A2A) payments are becoming the new standard. A2A payments – which involve transferring funds directly from one bank account to another – not only come with lower transaction costs, but can also improve the customer experience by eliminating friction and delays.

It's clear that banks and businesses need to evolve if they are to avoid obsolescence. But investing in a new payments infrastructure can be challenging, particularly when resources may be tied up with keeping the existing systems running, and keeping up-to-date with regulatory change.

By embracing agility, and working effectively with the right partners, financial institutions have an opportunity to harness modern payment instruments, transition to a more modern technology stack, and future-proof their payments.

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Legacy payment infrastructure: an endangered species

There's no denying that legacy payment systems are fraught with inefficiencies. Many of the systems currently in use are several decades old, including card schemes and much of the batch-oriented payments infrastructure. These platforms were designed for a world in which payments moved at a different pace, and lacked the integration opportunities now provided by modern technology.

The continued use of these systems is giving rise to a number of challenges for financial institutions and their customers:

Fraud risk

Legacy payment methods also tend to come with relatively weak security measures, giving rise to higher-than-necessary fraud risk. While card schemes have sought to mitigate this issue by introducing additional layers and elements on top of the legacy infrastructure, it can be difficult to retrofit security onto a long-established payment method.

Inefficiencies and high costs

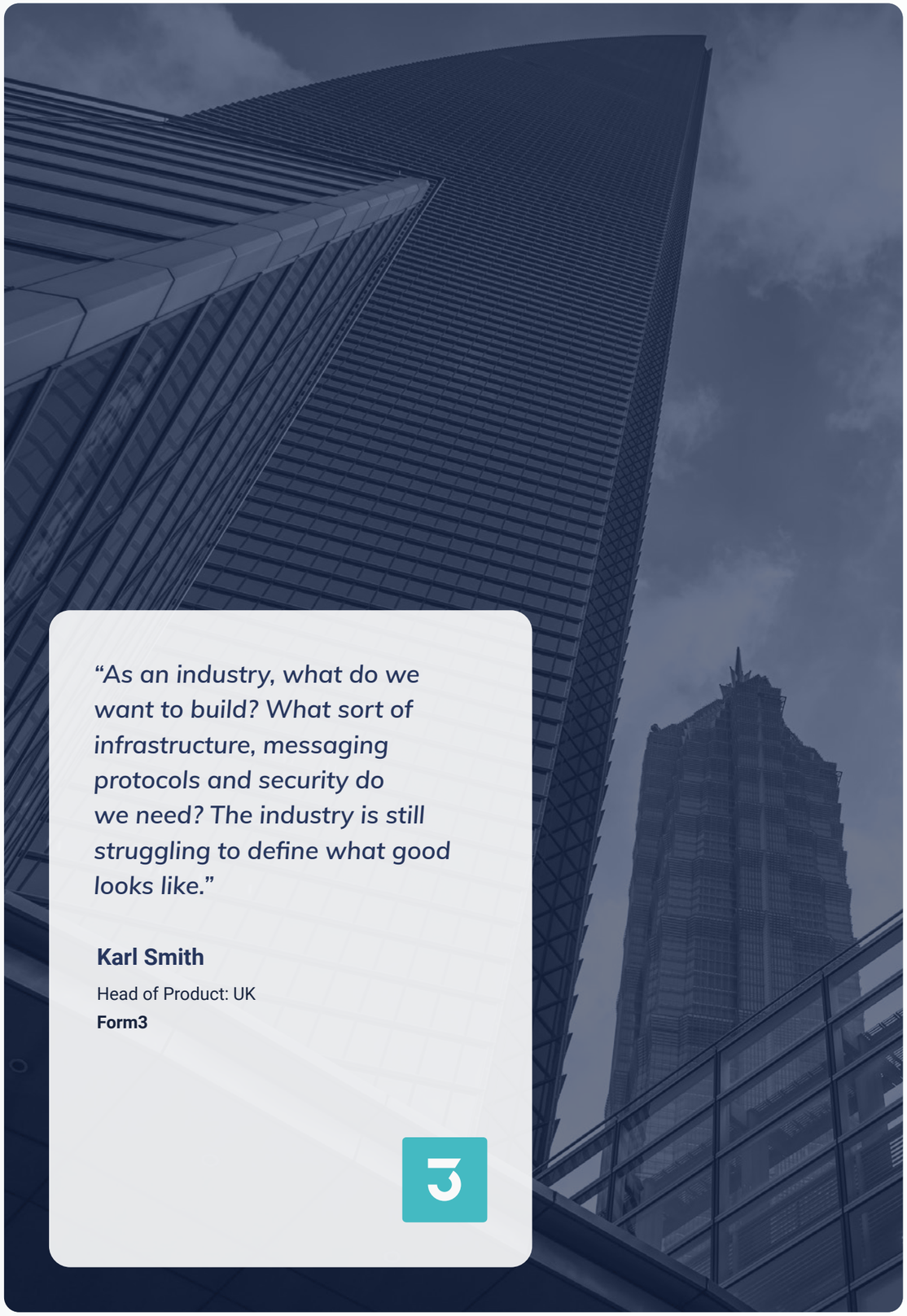
Legacy infrastructure tends to have a lot of intermediaries involved in the payment chain, resulting in lengthy processes. This, in turn, pushes up costs, with customers – both businesses and consumers – picking up the tab for these inefficiencies.

Cash flow delays

Where cash flow is concerned, legacy payment methods are associated with long processing times, due to the nature of the technical infrastructure and the specific counterparty risk models in use. As a result, businesses typically have to wait longer than ideal to receive incoming payments, and may lack visibility over when payments will settle.

Over time, many of these longstanding systems have remained relatively unchanged, while becoming older and accruing more risk – and the underlying challenges have not gone away.

At the same time, the underlying infrastructure is becoming outdated. The UK, for example, has been looking to replace its existing infrastructure for some years, first with the New Payments Architecture (NPA) programme, and more recently under the umbrella of the National Payments Vision (NPV).



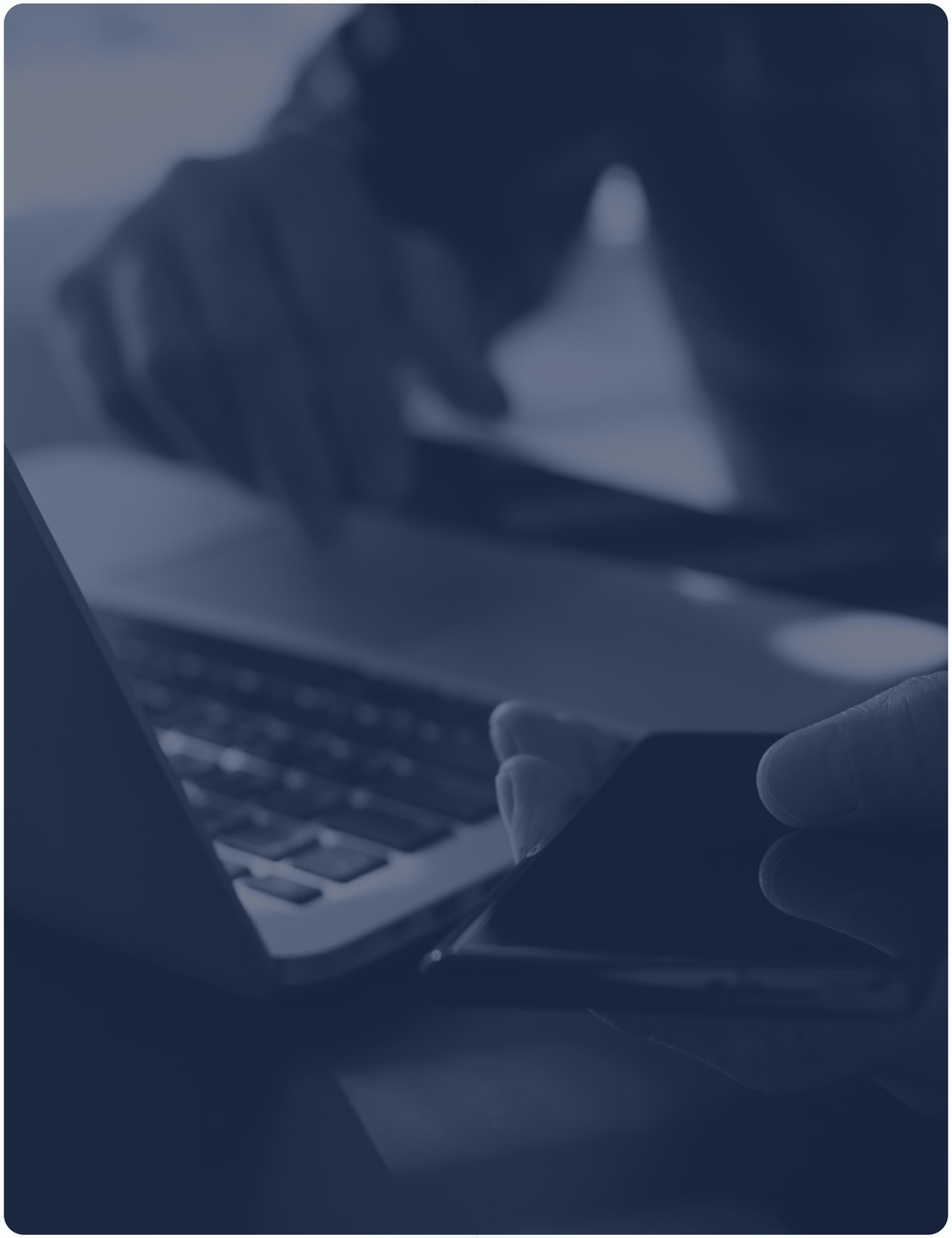
The rise of real-time

While legacy infrastructure may be fraught with challenges, the last ten years have brought a material shift towards real-time oriented payment methods. Compared to legacy payments, modern payment methods – such as instant payments powered by open banking – can generate significant savings, as well as enabling real-time settlement to the merchant or beneficiary.

Newer models can reduce the level of uncertainty over the timing of payments, and also the amount of time that people spend chasing late payments and overdue invoices. With the right platform, for example, businesses may be able to resolve queries on the spot, and confirm in real-time that payments have been received.

Cash flow delays can also be addressed by newer payment methods, which typically involve direct and immediate settlement to beneficiaries. From a cash flow perspective, reducing the cycle time by one or more days is a material benefit to businesses, which benefit from greater levels of control and more predictable flows.

And where fraud is concerned, newer payment methods are taking advantage of biometric security capabilities provided by smartphones, as well as bank-grade authentication, in order to make fraud more difficult.



Transitioning away from legacy models

Given the many advantages of A2A payments, momentum is continuing to grow around the transition away from legacy methods. Businesses are taking steps to access more modern infrastructure, with embedded payments presenting an opportunity to access modern payment systems and payment services using existing software packages.

To keep up with the pace of change, and harness newer technologies and payment instruments, many banks have embarked on ambitious transformation programmes. But in practice, implementing a more agile infrastructure and moving away from unwieldy legacy systems can be a challenging prospect.

Real-time account-to-account payments are the new standard

It's clear that the industry is seeing a significant shift towards real-time account-to-account (A2A) payments. A2A payments have much to offer compared to legacy payment methods: they eliminate friction, failures and delays, and are associated with lower transaction costs.

There are a number of reasons why the industry is embracing A2A payments. For one thing, consumers are increasingly looking for the same technology experience that they have in their day-to-day lives. As a result, payments are not only becoming real-time, but are also becoming more available for many devices, including mobile – all while benefiting from more sophisticated security measures.

Businesses, meanwhile, are motivated to adopt A2A payments both because of the cost savings they offer compared to traditional instruments such as cards, and because of the opportunity to increase key metrics such as conversion rates and retention rates:

Conversion. Where conversion is concerned, businesses want to make it as easy as possible for customers to sign up for their services, so it's important to ensure that payments do not present an obstacle to that process.

Retention. With more people embracing the subscription economy, it's essential for businesses to focus on keeping customers over an extended period. Modern payment methods such as A2A payments tend to be optimised for that model to a greater extent than cards, which expire every few years.

Enablers of A2A payments

Open banking has proved to be transformative in this space. As a result of open banking, payment providers can capture and authenticate the payer's information in real-time, using the security infrastructure that the payer has in place with its existing bank. This has opened up the use cases that can be served by A2A payments, which can be deployed online, in ecommerce transactions, and even in the physical world.

At the same time, the infrastructure in most countries has moved from a multi-day clearing cycle to a real-time clearing cycle – although the speed of adoption varies between different countries and regions. While the UK was an early adopter of real-time payments, for example, Europe has made the move to real-time more recently with the expansion of the SEPA Instant Credit Transfer (SCT Inst) scheme – thereby enlarging the market that can be addressed by A2A payments.

The characteristics of real-time payments – namely the pace and 24/7 nature of these instruments – is a more natural fit for fintechs than for many banks. Many fintechs in this space have a clear focus on convenience and easing the adoption process, as well as partnerships with multiple software platforms that embed their payment solutions. As such, users of real-time payments and open banking are tending to gravitate towards fintechs that have the necessary technology platforms and service models.

"The A2A payments landscape tends to include more regional players, so businesses may need to integrate with multiple banks across geographies to achieve any kind of footprint. GoCardless, in contrast, has an established footprint across many currencies, and a single integration that customers and partners can leverage."

Brian Hanrahan

CEO
Nuapay - a GoCardless company

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> *"A lot of banks are looking at partnerships with fintechs such as Form3 and GoCardless. With this approach, banks can leverage the technology investments their partners have made in order to meet their customers' needs and retain the primary customer relationship."*

Brian Hanrahan

CEO

Nuapay - a GoCardless company

How financial institutions can future-proof their payments

In this environment, it's essential for banks to future-proof their payments. Above all, this means being agile enough to adapt to any changes that may be introduced in the future – particularly regulatory changes, which play an important role in the evolution of payments.

In Europe, there is a continued push to open up access to clearing to non-banks, and to improve the level of competition and innovation in the payments market. In the UK, meanwhile, the recently published National Payments Vision (NPV) could require the entire industry to move to a new target architecture.

Banks should be investing today in order to capitalise on the new architecture, once it has been defined. But firms may also be reluctant to invest in change until regulators have confirmed what is needed.

As Brian Hanrahan, CEO of Nuapay, observes: "A lot of banks have competing priorities around the need to maintain a legacy infrastructure while keeping up with regulatory and market changes. It's quite challenging to invest in moving forward when a relatively small proportion of their capacity is allocated to innovation or change."

Harnessing agility

When it comes to future-proofing payments, an effective solution is to work with technology providers that insulate customers from future changes. For example, if new fields are added that carry fraud data, a modern provider can do all the work needed to populate these fields.

While payments may represent one important aspect of a bank's relationships with its customers, it may not be the main element of that relationship. In practice, banks will be focusing on retaining the overall relationship by making sure their customers' needs are met.

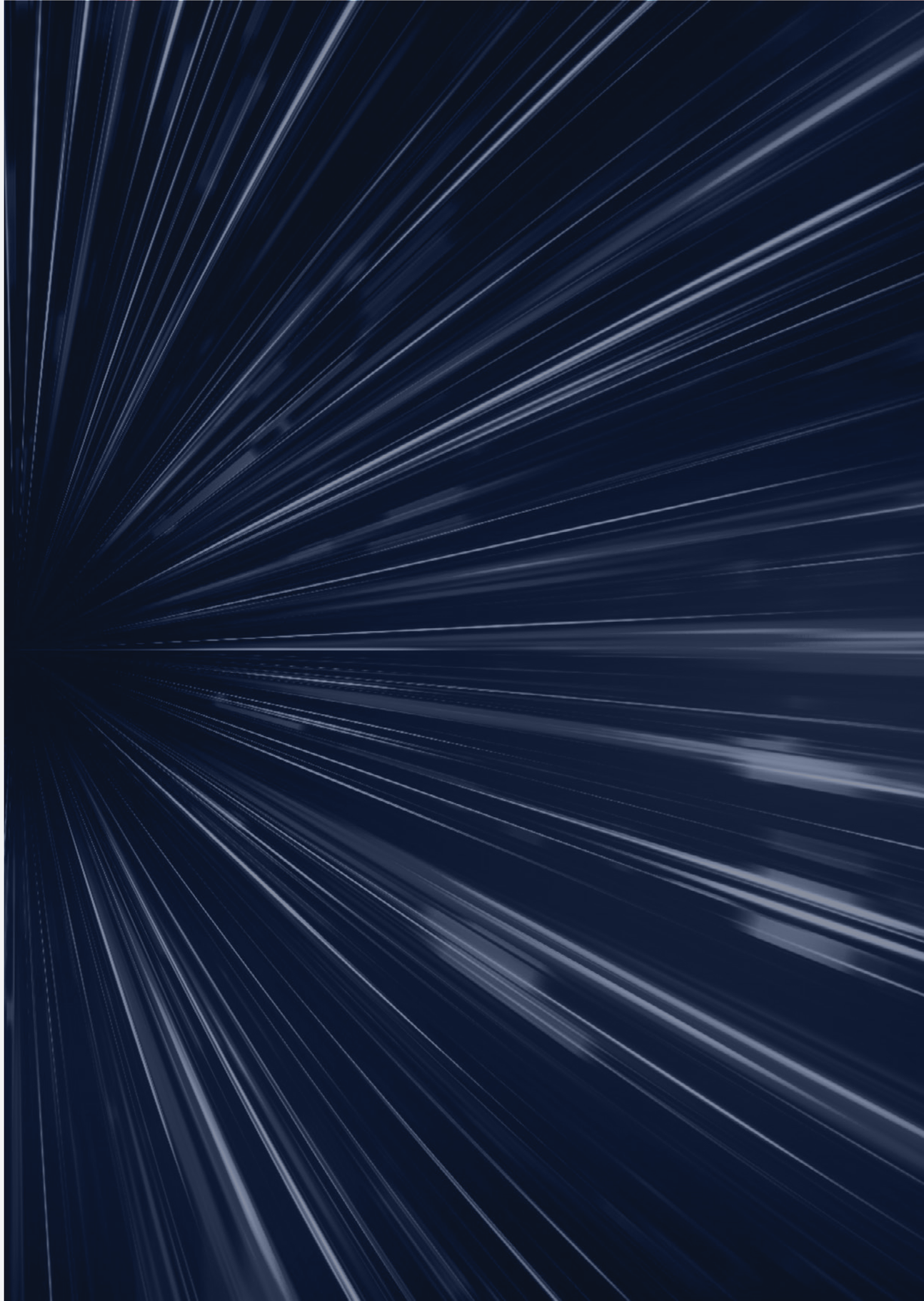
This can be achieved by leveraging partnerships with fintechs – either through referral models, whereby the bank directs customers to trusted partners, or by white labelling technology from a partner. Whatever the chosen approach, there is a clear need for banks to be ready to adapt to future changes and regulatory requirements.

Conclusion

In a changing environment, evolution is key to survival.

Legacy payment infrastructure lacks the ability to meet customers' expectations for speed, efficiency and user experience.

With customers increasingly seeking access to modern infrastructure and A2A payments, banks have much to gain by partnering with fintechs that have the technology platforms and service models needed to support real-time payments.



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Form3 is the account-to-account payments platform. Founded In 2016, Form3 set out to revolutionise the world of payment processing and disrupt the traditional payment infrastructure model, with an always on, cloud-native, Payments-as-a-Service platform. Providing not only gateway services its breadth and depth of solutions extends to fraud prevention, payments orchestration as well as data metrics. Today, Form3 is trusted by some of the UK's and Europe's biggest Tier1 banks and fastest-growing fintechs to handle their critical payments architecture. Form3 has been included in the 2024 Lazard T100 Index and was listed in the 2024 Top 100 Scale-ups in Europe. The company has also been awarded PayTech of the Year and Team of the Year for Form3's Engineering Team at the UK Fintech Awards 2024, Accel Euroscape 2023 Top 100 Company, Tech of the Future for Banks & Financial Institutions 2023 by the Paytech Awards, and Engineering Team of the Year 2023 at the Europe Fintech Awards. For more information visit **www.form3.tech**