THE MI OF TOMORROW

Cyrus Bhathawalla of KPMG asks not what payments markets infrastructures (PMIs) can do for themselves, but what they can do to help their customers. He believes PMIs must evolve their business models by treating technology as a tool rather than an end-in-itself; putting the needs of their customers at the forefront of innovation; taking an interest in new entrants while minimizing competition with existing clients; and viewing regulation as an opportunity to reassess a capability rather than as a cost to be endured.

“Innovation is bound to continue in this space, and payments market infrastructures (PMIs) need to evolve with it,” says Cyrus Bhathawalla, a managing director in the financial services and payments consulting practice at KPMG. “If they do not, the role of PMIs, including their role in providing safety, security and resilience will gradually be eroded.”

Technology is not a solution but an enabler

The interesting question, he adds, is what is making that evolution necessary. A popular candidate is technology. Application programming interfaces (APIs), artificial intelligence (AI) and machine learning (ML), robotic process automation (RPA), and especially distributed ledger technology (DLT) are often said to be enabling a disintermediation of incumbents.

Bhathawalla is not convinced. “It is easy to treat technology as a hammer looking for a nail,” he says. “All organizations – not just PMIs – should understand the problems they are trying to solve, or the capability they are trying to deliver, prior to trying to find the answers. Once the problem is thoroughly understood, different solutions or partnerships involving the appropriate technologies can be assessed.”

The driver of change is customer experience

At present, the payments industry is not struggling with reliability or scalability. The problem its incumbents face is how to enhance the customer experience, not necessarily the underlying process. A number of FinTechs are having success in disintermediating the traditional bank-customer relationship through focusing principally on the customer experience. The challenge this sets for PMIs is how to stay relevant to the banks – the majority of their user-base.

Even the most successful FinTechs continue to rely on the same PMIs as the incumbent banks. Even highly adopted FinTechs, such as Venmo, which is owned by Paypal, would find it impossible to pre-fund digital wallets, or facilitate payments, if they did not leverage existing PMIs.

“At the moment, FinTechs are happy to ride on the current infrastructural rails, because it is the only way to move money between bank accounts,” explains Bhathawalla. “But they are in effect creating their own clearing systems. That puts banks at risk of not owning the customers’ end-to-end lifecycles.”

Of course, the banks are not ignoring this reality. “Many are responding by heavily revamping their own customer experience, partnering with or acquiring customer experience firms, and even launching their own digital-only banking arms to deliver a wholly new experience,” says Bhathawalla. “And regardless of intermittent pummelling by the media, they benefit from holding one trump card – trust.” Reinventing the customer experience is not an easy task for banks lumbered with legacy technology and high levels of regulation. But PMIs can help them – and it is in the interest of PMIs to do so.

As servants of a banking industry increasingly focused on the customer experience, PMIs can no longer rely on their reputation for process, safety, and soundness alone. Their users are asking themselves how a payment looks and feels to the customer. As the infrastructural foundation of that customer experience, they need to do the same. “PMIs need to tread the fine line between the customer propositions their users offer and enabling the technology they provide to those users,” explains Bhathawalla.

FAANGs (Facebook, Amazon, Apple, Netflix, Google) could develop alternative PMIs

And their challenge is not restricted to supporting their existing users only. PMIs could choose to appeal to the competitors of their users too. “PMIs need to innovate to stay relevant,” says

"Understanding customer behaviours such as spending habits, can empower companies like Amazon to intelligently cross-sell and up-sell financial products."

- Cyrus Bhathawalla
Managing director
Payments, financial services
KPMG

Bhathawalla. "No matter how much we deny it or refuse to make provocative statements, certain corporate organizations are developing proprietary PMIs."

He points to Chinese-based AliPay (the second largest mobile wallet provider in the world, with an estimated 650 million users by end-2018, after launching as recently as 2004) and WeChat (one of the single largest payments networks in the world, with over 1 billion potential users). WeChat is already an accepted means for paying merchants in parts of London, Australia, and on the west coast of the United States.

But Bhathawalla says larger technology firms such as Amazon, whose understanding of its customers' behaviour is unprecedented, are potentially the most disruptive of the new contenders. Amazon is already in the financial services business in the United States. It issues small business loans via Amazon Lending, pre-paid cards via Amazon Cash, and is cutting into banks' fee revenues via Amazon Reload.

"We expect this to expand even further as technology firms begin to apply for banking charters," says Bhathawalla. "One of their key capabilities is to their ability to do extraordinary things with data analytics, alongside their strong customer experience and the loyalty and trust they have generated already. Understanding customer behaviours such as spending habits, can empower companies like Amazon to intelligently cross-sell and up-sell financial products."

Infrastructures could bring trust to crypto-asset markets but may not be welcome

"Could PMIs break free of the banks that own, control, and utilize them?" asks Bhathawalla. "Will they become service providers to payments FinTechs, crypto-asset issuers, and investors?" He argues that the market-leading technology of FinTechs cannot compensate for the trust which banks have retained despite everything that has happened since 2007. In fact, the crypto-asset markets, which are characterized by extreme price volatility and worryingly large defalcations, have the opposite problem: lack of trust.

So it is not surprising that Bhathawalla sees a potential opportunity for PMIs to bring trust to the crypto-asset markets by servicing issuers, settling transactions, and keeping crypto-assets in custody. "There could be a role for PMIs in implementing some of the disciplines they already apply to the payments markets," he says. "That experience could be invaluable in a space which is moving as fast as crypto-assets. Infrastructures can offer cyber-security but also stability, in the shape of trading and valuation controls, as well as learnings from existing rules and policies that drive stability."

He adds that protecting the interests of end-customers is a natural role for PMIs to play. But Bhathawalla also warns PMIs that they should not imagine they will be welcomed by crypto-asset issuers, exchanges and investors, whose culture is hostile to the status quo.

Another ripe opportunity for PMIs is cross-border transactions. Bhathawalla says the success of both SWIFT gpi and FinTech TransferWise indicate an appetite for greater efficiency and visibility in cross-border payments. "The need for greater efficiency, transparency, speed and reduced cost in international money movement and, most importantly, removal of friction in the customer experience, is becoming more obvious at an exponential rate," he argues.

Fraud prevention and KYC due diligence are opportunities for infrastructures

Aggregating the data necessary to combat financial fraud, facilitate Know Your Customer (KYC), anti-money laundering (AML) and sanctions screening represent a further opportunity. They are, says Bhathawalla, obvious cases for a utility model or information-sharing. "Not only would it mean the banks invest only once," he explains. "They would also be pooling their data. So PMIs can help their customers to deliver a better service, reduce their costs, cut fraud and compliance risk, and improve security across the entire network."

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The MI of tomorrow

24 October 2018
14.00-15.00
Conference Room 2

Moderator:

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Simon Eacott
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NatWest

He adds that collaborative ventures between PMIs and banks work best where the lines dividing their activities are blurred already. The New Payments Platform (NPP) in Australia, for example, brought together a central bank, the payments regulator, the commercial banks, and a PMI. Bhathawalla cites the New Payment System Operator (NPSO) in the United Kingdom, which has brought together multiple banks and PMIs, as another example of value-adding collaboration across the silos.

The NPSO was in part sparked by the Payment Systems Regulator in the United Kingdom. Bhathawalla agrees that regulators can initiate meaningful change in PMIs, but he believes their influence over the subsequent evolution of services is easily exaggerated. “Regulation is over-used as a driver of innovation,” he says. “In reality, it is more common for market participants to use regulation as a strategic driver of innovation by enhancing existing products and services while enabling net new products and services on top of these.”

Regulatory and commercial interests combine to drive change further and faster

As the design lead for the KPMG team that helped the Australian banking industry deliver the NPP initiative, Bhathawalla has first-hand experience of how regulatory and commercial imperatives intertwine to drive change. Although it posed a challenge to their existing business models, the Australian banks chose to actively support the NPP project because they wanted to drive the evolution of the platform, rather than lose control of their destiny by submitting passively to a regulatory mandate.

In the same way, banks in the United Kingdom (UK) initially adopted Faster Payments under a mandate from regulators to speed up payment clearing times. But, once the change was agreed, it was the banks, not the regulators, which drove the infrastructural requirement to accelerate the payment speed to near-real-time. This went much further than the regulators anticipated – and enabled the banks to deliver a truly innovative service.

“The decision to move to a centralized hub of real-time, sub-ten seconds funds availability was made by the UK banks, not the regulator,” explains Bhathawalla. “The head of global transaction banking at a major UK bank told me that there was no point in innovating only part-way, and that they may as well make a complete job of it, predicting that real-time banking was going to be driven by the advent of real time e-commerce in the future anyway.”

This combination of government initiative and infrastructural development can be healthy. In fact, implementation of regulation without regard to the wider opportunities it represents can make true innovation more difficult. After 9/11, for example, the United States passed a law (Check 21) to permit digital images of cheques to be cleared. This obviated the risk, made plain by the potential drying-up of liquidity on 9.11, of continuing to rely on cheques being moved physically around the country in aeroplanes.

But instead of treating Check21 as an opportunity to wean their customers off cheques – by, for example, charging customers more to use them - the American banking industry collectively invested in the region of $3 billion in making the processing of cheques more efficient.

Bhathawalla acknowledges that Check21 reduced costs in the processing of cheques but argues that even larger costs and expensive infrastructure remained in place. “If you are continuing to innovate on cheque processing, you are missing the forest for the trees,” he says. “PMIs always need to think more broadly, and further into the future, than the opportunities directly in front of them.”

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