



Payments Innovation Is Critical for Every Global Enterprise

An  **xtrm** White Paper



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As fintech software and service innovations continue to disrupt the Financial Services market, even non-financial firms need to think about how to take advantage of this trend to improve their payments processes for the benefit of the company, their customers and their partners.

An Industry Ripe for Disruption

It is clear that banks and financial institutions recognize the need to provide a better user experience for financial services and are working hard to offer new and innovative solutions. Over the course of the past decade, they have attempted, with more or less success, to deploy more consumer-centric solutions, such as mobile wallet, mobile banking, and P2P (peer-to-peer) payment solutions. But it is also important to observe that most banks are following a me-too strategy when it comes to offering new, digital based, financial services and customer experience. Indeed, most of these new services have been developed in response to other players in their ecosystem, the fintech and big tech companies, that are disrupting the old model with new innovative, customer centric services.

More often, financial service businesses operate in an environment governed by hard-line regulations and the need to meet both global and local compliance standards. Bank secrecy, security terms, the lack of trust in technology, and strict regulations have slowed down their development and innovation.



In the long term, the financial services market will continue to evolve as innovation from fintech startups and Big Tech players (ApplePay, Google Wallet, etc.) expand the possibilities for financial processes. Over time, these innovations will trickle down into the mainstream, creating opportunities for nearly any business.

Yet rather than waiting for new capabilities to trickle through their financial institutions who adopt or incorporate services that emerging fintech firms have introduced, businesses today can look to their own process and incorporate them directly into their value chain. There are now readily available point solutions across a number of financial process innovations - from mobile payments to invoicing/billing; from payroll and trading to financial packaging and even distributed ledger technology - which can be tapped today; many of which may have significant impact immediately.

No area of financial services, however, is both as ubiquitous and as ripe for immediate improvement as global payments, projected to exceed \$3 trillion dollars in global payments revenue by 2023 according to McKinsey's Global Payment Practice.¹ Considered from the SME, large corporation or ISV/SaaS provider perspective, that revenue translates into their cost of doing business... an exciting growth opportunity to peel away some of these global banking fees!

¹Global payments 2018: A dynamic industry continues to break new ground, McKinsey Global Payment Practice



Global Payments Innovation – Not Just for Financial Institutions

Financial institutions have traditionally owned the market and defined the limits in the area of payment solutions. Few, other than the cryptocurrency players thus far, have moved fully beyond the traditional banking systems and the card processing networks.

These payment ecosystems remain the primary endpoints for receiving and making payments and will remain so for the foreseeable future. Despite that reality, there are tremendous opportunities for firms outside the financial industry to take advantage of new capabilities, the potential of new payments platforms and digital wallet architectures to support myriad business workflows including sending, receiving and exchanging funds and the use of APIs to embed these payment processes within their own software solutions.

Waiting for the banks or even Big Tech to create new capabilities only puts your firm at the mercy of their business strategy—assuming they bring forward the capabilities that meet your needs rather than requiring you to define your needs in the context of their capabilities. Indeed, there are compelling reasons not to wait but rather to take near-term actions that can:

- drive greater operational efficiency
- lower operating costs
- improve customer or partner experience
- aggregate account views to improve workflows
- provide greater flexibility
- eliminate unnecessary fee-based services

Simply by understanding the needs of customers or partners, businesses can implement existing payments solutions that take away the complexity, cost and compliance burden of making global, secure and rapid cash or non-cash payments. By simply integrating flexible payments technology, companies and developers can easily simplify and control the user payment experience associated with any business process to address nearly any payment use case including complex multi-tier and multi-currency applications.



Using Digital, Mobile and Global Payments Architectures

It's All About the Experience with Ample Room for Process Improvement

Customers, of course, have been the ones most impacted by financial services firms' lack of agility—whether they need to open an account, send money overseas, pay their suppliers and partners, receive payments from their customers or trade in multiple currencies. And, while the consumer markets have seen relatively rapid implementation of new services, particularly in mobile banking, the B2B market continues to lag behind in business-centric services although new players have emerged.

In their October 2018 whitepaper,² McKinsey & Company and SWIFT identify cross-border payments as one segment that remains concentrated in B2B. While we believe that is likely to remain so, consumer to business (C2B) remittances are growing more rapidly than any other cross-border category. The likely nature of changes in cross-border payments, according to the McKinsey and SWIFT report, include three key points:

- Shifting growth: There will be many more cross-border payments than today but growth might not come from the expected sources (new use cases)
- Customers rule: They will define the nature of future services, not providers, e.g. FIs (new capabilities)
- Integrated experience, fragmented production: Fragmentation of the value chain will continue ... but it will be integrated into user solutions... production differences ..not visible to end user (embedded functionality)

In short, no matter how fragmented the value chain, nor how many new use cases and new capabilities emerge to meet demand, the customer experience must be paramount. And inversely, as long as the customer experience is integrated and seamless, the value chain can be de-constructed to allow for best-in-class components at each stage rather than counting on a sole supplier to be best of breed at every stage.

Payments Platform for B2B Use Cases - Receivables, Payables and P2P

The term 'digital wallet' has become ubiquitous and is often used interchangeably with 'mobile wallet' to describe widely disparate solutions including anything from your bank's online system or mobile app, to your wallet at a major retailer, or ApplePay, GooglePay or PayPal.

² A Vision for the Future-of-Cross-Border-Payments, McKinsey & Company and SWIFT



However, the use of digital wallets in the B2B marketplace is still in the early stages and its potential for addressing myriad B2B use cases and even new business models is only now becoming apparent.

Using digital wallets in tandem with an independent payments platform offers the ability to outsource or offload much of the administrative burden associated with making, reconciling and reporting payments to partners and customers.

Further, an independent payments platform can support multiple digital wallets within a single account for both Payers and Payees.

- Funds can be sourced from nearly anyone, anywhere and via multiple methods (ACH, card processing, etc.) in many currencies.
- Funds can be sent to anyone, anywhere as long as they have a digital wallet on the platform; and, if one does not exist for a Person or Company, one can be created dynamically along with a Pending Account.
- Pending Accounts can be updated by the Recipient using self-serve tools to provide the additional details required for Know-Your-Customer (KYC) and Anti-Money Laundering (AML) compliance.

These intra-platform movement capabilities have a profound impact on how digital wallets can be architected to support incoming payments (AR) and outgoing payments (AP) as well as wallet-to-wallet (W2W) movement to facilitate P2P payment, currency exchange (FX) or aggregating payments for more efficient payment workflows with partners and affiliates. Using a payments platform also offers the ability to offload administrative burdens related to AML and KYC compliance and tax reporting.

Mobile Access to Attract Customers vs. Barrier to Entry

The digital wallet has become the standard for 'Customers.' However, Customers in the Financial Industry context supposes that you must ensure KYC compliance for every account, as well as screening transactions for AML compliance.

For prospects, potential partners and even some indirect customer relationships this can become a barrier to making payments that is simply too high. The process of fulfilling KYC requirements as a precedent for doing any form of business is often unwarranted when the relationship is not yet fully engaged. This seems particularly annoying when one remembers that in nearly all uses cases, at either endpoint coming into or out of a payments platform is a known as a 'Customer' of a bank (ACH) or the card payments network.



Using an external payments platform enables all parties access to all the transactions pertinent to them while shielding their payees data beyond the transactions specific to their business relationship. This means an aggregator can see all of the transactions from hundreds, even thousands of users while each user can see all the transactions that they have either initiated or been the recipient of from all other entities using the platform. Imagine, for example, a referral or reseller partner or sales rep receiving rebates, rewards or commissions from the multiple vendors whom they represent. Each vendor has visibility to their business but no line of sight to the consolidated wallet of the payee.

Mobile and online access to the payments platform can be enabled via widgets requiring little or no programming, or white-labeled and fully embedded into your workflow via APIs. The platform can then manage user identity in the platform to comply, as needed, with KYC and AML requirements.

Increasing Use of Cross-border Payments – Improved FX

As discussed earlier, cross-border payments are a growing payments sector. And one where transaction fees and FX are often very high even, accounting for nearly all of the C2B global payments revenues and 83% of B2B global payments revenue.⁴



A key feature required of any global payments platform to facilitate cross-border payments is the ability for all users to Send, Receive, Fund, Exchange and Transfer in multiple currencies. This can be accomplished by provisioning each account as many digital wallets as required to complete any planned transactions as well as by empowering the account holder with the ability to create as many currency-specific wallets as desired. This enables either party to complete the FX exchange on the payments platform—generally at far more attractive FX rates than found at traditional financial institutions. Once in their local currency, an account holder can Transfer to any external endpoint available to them based on their profile.

W2W exchanges can occur between account holders as long as both using the same currency. Typically, W2W activity does not incur any fees.

⁴ A Vision for the Future-of-Cross-Border-Payments, SWIFT and McKinsey & Company



Leveraging APIs to Optimize the Payments Value Chain

As we have seen for more than a decade now, fintech companies have been accelerating innovation and elevating customer expectations when it comes to having accessible, fast and user friendly financial services. Fintech and Big Tech companies alike put user experience at the heart of their offer—enabling consumers and businesses convenient self-serve, online and mobile access to financial services. Thanks to the explosion of APIs, these capabilities can be stacked in unique value chains with far less development time required

Fintech and Big Tech are working from the ground up to solve financial services challenges, while financial Institutions and banks are working in their highly regulated framework, focusing on delivering compliant solutions. That said, each rely heavily on APIs to create their respective value chains.

Type of APIs

An API is a set of functions which allow for sharing data and requests between systems, usually, in a controlled, secure manner. There are three types of APIs with widespread use in finance:

- Internal APIs used for sharing data across internal systems and users.
- Partner APIs (private APIs) that let banks and payments processors exchange data with their partners.
- Public APIs (open APIs) that allow for sharing.

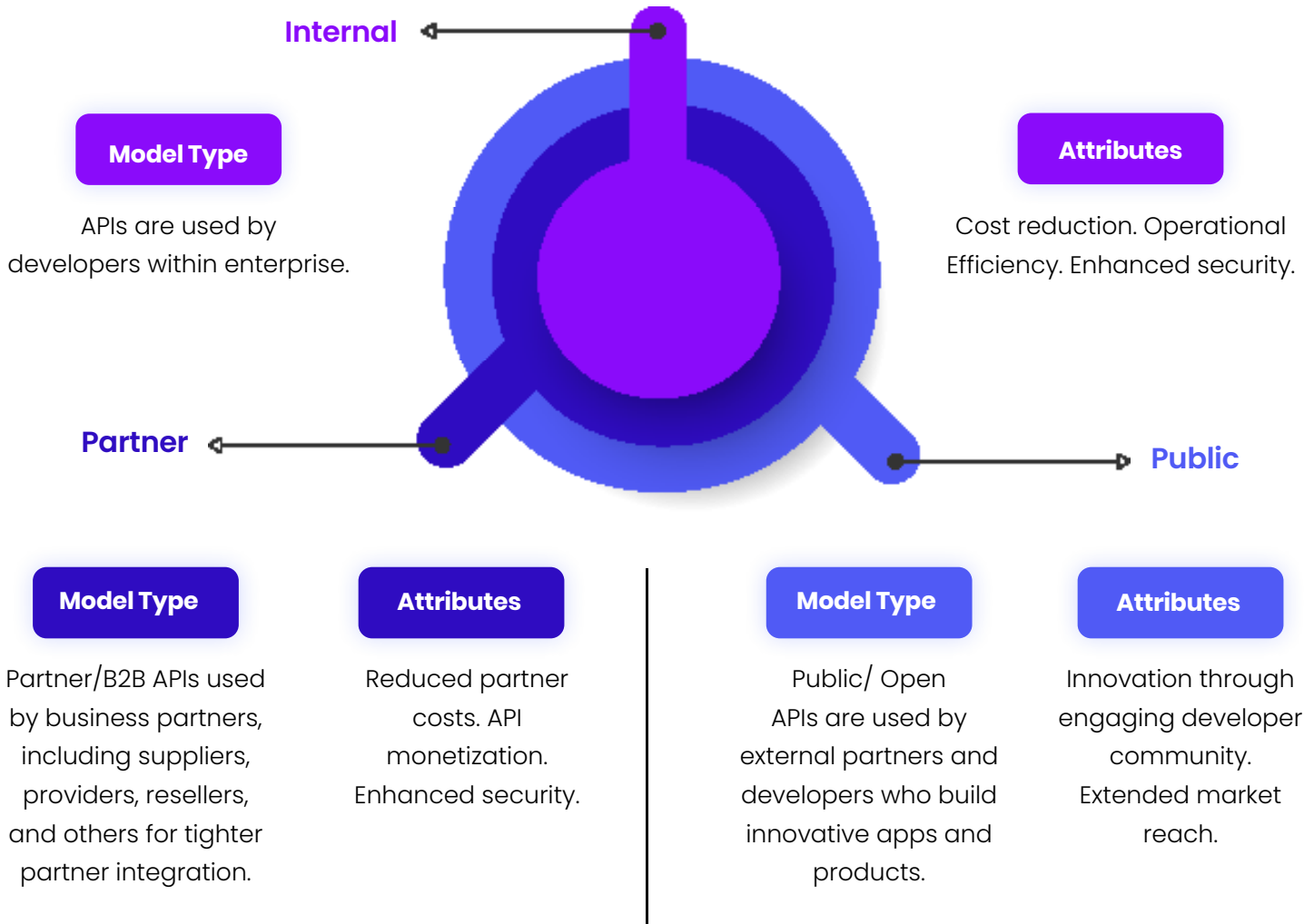
Indeed, APIs are essential to enabling non-financial services firms to integrate global financial services. An example of such services is customer data aggregators that source data from several banks and provide it to developers on the basis of the open banking concept.

With the customers pain points in mind, they are ultra agile and expedite time to market. A fintech company can launch a new feature or even whole new products in a matter of weeks, where a financial institution might take months, or years, to have new products up and running.

The most common financial institution offerings are payment related APIs, which facilitate initiating payments and receiving basic customer information like account and profile data. Currently, the widest spectrum of integration options is available on the European market as EU legislation obligates banks to comply with PSD2. While Asia and North America lag behind, local players also provide some open banking options for developers.



Three types of APIs API Models





Implications for Non-Financial Firms

What does this mean for non-financial institutions? How can your company take advantage of the fintech disruptions particularly as related to payment solution?

The first step is assessment. It's one thing to become aware of opportunities to reduce operating expenses, lower costs for your partners or customers, streamline business processes or improve your partner and customer experience. It's another to quantify their cost and impact. And then to act:

APIs are readily available to manage nearly every aspect of payments, inbound and outbound, including offloading KYC and AML functionality to a payments platform, and providing mobile friendly self-serve tools for customers and partners.

Automating payment processes with a global payments platform that leverages the capabilities of an intelligent digital wallet architecture creates operational efficiency and lowers operating costs by automating and simplifying core payment processes.

Typically, banks and traditional financial institutions create a full customer profile as the first step in building a business relationship, prior to conducting any transactional business. While this is important for their business and essential to complying with regulatory considerations including KYC, AML and tax reporting, it also creates a significant administrative burden and cost.

Payment networks make e-commerce transactions more convenient for both customers and merchants by eliminating the need for KYC at the transactional level. In these networks, there is an Issuing Bank (Customer and a Merchant Bank for each transaction; each has an already vetted, KYC compliant relationship with anyone on either side of the transaction. Payment gateways, however, may be needed which adds considerably to the transaction processing expense.

An intelligent Payments Platform, however, can perform many of the functions of a payment gateway. More importantly, it operates in a manner that is somewhat analogous to the payment networks albeit with more choice in payment methods, inbound and outbound. What is similar to the payment networks is that transfers out of the platform are typically made via ACH, SWIFT or wire transfer, meaning that the recipient is a customer of the bank that has also taken responsibility for KYC and AML compliance.



There are four key ways that an intelligent payments platform creates benefits for its users and value for its aggregators:

1. Identity/Access: From Unknown to Known

An intelligent payments platform provides functionality beyond that of a payment gateway or payment network as the payments platform also completes full KYC and AML compliance for all users. It does so iteratively in order to move accounts through the four stages of identify with minimal friction:

- Pending accounts are unable to conduct currency exchanges or transfer funds externally until their account meets basic AML and KYC requirements.
- Basic, Standard and Advanced accounts capture progressively more profile data and earn correspondingly higher caps to the volume and velocity they may conduct on a daily basis.

This iterative process ensures all with the visibility needed to manage their activity without requiring an undue burden for prospects and/or transactional users who never reach the threshold required for KYC, AML or tax reporting.

2. Aggregation: Supports More Optimal Business Workflows

Payment platforms incorporating intelligent digital wallet architectures enable simpler, frictionless movements of money in new ways that make doing business easier and more cost effective. The ability to design and track the flow of funds between a company and its connected partners, affiliates and customers opens new possibilities. By taking advantage of the visibility and instant nature of payments, multi-tier relationships can be created and managed in near real-time. And connected accounts can be configured to support any number of multi-currency wallets making it far simpler to manage global payments as described below.

3. Compliance: Shifting Burden Improves Operational Efficiency

Payment platforms, of course, must provide security and compliance similar to those required for internally hosted solutions including PCI, GDPR, SOX, ISO 27001, ISAE 3402, SOC 1, 2, 3 as well as 2-step authorizations and encrypted data.

Additionally, a key benefit to outsourcing KYC and AML compliance requirements and tax reporting functionality to an external payments platform is to dramatically reduce operating expenses whether these functions are



currently being done internally as a service on behalf of your customers and partners, or externally by a financial institution or other third-party.

Self-serve tools for users to complete and update their Account and Profile information lowers data management costs. And the payments platform should automate KYC compliance at the account level and AML screening at a transactional level.

4. Fungibility: Expanding Choice and Lowering FX

Using an external payments platform and properly designed digital wallet architecture offers business the ability to receive and send payments that meet their needs and better serve the needs of their customers by allowing the transfer of funds out of a digital wallet via any number of payment methods. When available, this provides end-users with the opportunity to control their choice of payment methods.

These methods include transferring via:

- direct deposit into a recipient's bank account via ACH, SWIFT or wire transfer
- prepaid debit card, digital gift card or other non-financial payments platforms

It also enables currency exchanges fully within the platform at much lower FX rates than available through banks, and allows for either party to absorb the FX expense. Companies can then pay in their preferred currency and recipients can receive money in theirs.

While an intelligent payments platform is not a replacement for the current set of payment facilitators including banks, card networks and payment gateways, its ability to interoperate with each of them to provide a greater choice of payment methods, simplified cross-border payment execution and greater flexibility at a lower cost should not be overlooked. For more information on how intelligent payments platform can advance your business, reach out to Xtrm at xtrm.com or any of its business partners.

It's one thing to become aware of opportunities to reduce operating expenses, lower costs for your partners or customers, streamline business processes or improve your partner and customer experience. It's another to make it happen.

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