Fireside Chat with Peoples Group on “All Things Payments”

Part 3 in a 5-part series sponsored by CGI and Celent.

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Introduction

Gareth Lodge:

Hello, and welcome to this series of All Things Payments, where I have a series of fireside chats with a number of CGI's clients. I'm delighted to say I'm joined by Bruce Duthie from Peoples Group today. My name is Gareth Lodge. I'm a principal analyst at Celent, and I'm going to be talking with Bruce about all things payments. So perhaps Bruce, is it worth just giving a little bit of an introduction as to who you are, your role, and of course, a little bit about Peoples Group itself?

Bruce Duthie:

Most certainly, Gareth, and first of all, thank you very much for having me on this forum. I think it's a great opportunity to kind of come out of the day-to-day world of banking and step up and have conversations about real structural and strategic things that are going on in this highly dynamic environment. So thank you very much for having me join this platform. Simply, from a kind of regulatory standpoint, I'm the chief risk officer for the Peoples Group. We are a Schedule 1 regulated bank and trust and loans company in Canada. We have been in operations for nearly four decades, starting really focusing on commercial, commercial banking, commercial lending.

And then, over time, as banking and the needs for banking evolved and expanded, we adapted and adjusted and grew our operations and organization to align with those needs in society, whether it be payments, whether it be direct banking, whether it be cards and other forms of digital services. We really wanted to keep pace with the social needs of banking and the commercial needs of banking and be a compelling and meaningful player in this space. Payments soon became a centerpiece to our strategy, recognizing that, in order to be an efficient and effective and reliable contributor to this ecosystem, being able to move money efficiently, securely, and reliably was fundamental to our service offering. And hence that, our digital presence and expanded growth strategy have really kept payments as one of the key pillars to that approach.

Gareth Lodge:

So I fully agree with you. I'm surprised by how many other banks don't see payments are so critical to their kind of, not just existence, but their future as well.

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Partnership

Gareth Lodge:

So I guess you must have some quite strong opinions on that payment providers, the kind of technology providers that you are reliant on. Do you see them just as a vendor? Or they're something more like a partner? And indeed, what makes a good provider of technology for you?

Bruce Duthie:

Yeah, I think that's a really important point you've brought to the surface, Gareth, and a lot of banks, I would say kind of mid-size banks, who are not in the direct clearing space, who are not really putting payments at the center, often talk a lot about wanting to become a payments bank, a payments-centric bank, but recognizing, to get over that, to cross that chasm between being a payments bank and not being a payments bank, is a very... It's not for the lighthearted. You have to have the grit and the expertise and also the right partnerships to make this journey.

And so, when we kind of selected CGI to be our kind of partnership, core partnership, in making that transition, becoming a direct clearer, we saw that two kind of elements were really important in that selection. One is that it's an approach to innovation and recognizing that, to make that cross into a new world of being a payments bank, required open thinking, recognizing all things might not work on day one, that you push status quo, you really think outside the box and really develop compelling use cases to see what's the art of the possible.

So that's on the innovation side. And where the rubber really hits the road is on the execution side. So we were looking for a partner that had gone through the battles, who have got the war wounds and the scars to say, "This is what it really takes to make that cross." It's one thing to do it on a whiteboard. It's another thing to put it into practice. So having the expertise, the experience, the talent, the decision-making, through that whole journey, was critical to our confidence as an organization to make that leap. So I'll just unpack that a little bit, just so we can appreciate the elements of a partnership that really do make a difference. One, I mentioned the ideation. One, having that vision of what could be possible when this transition takes place and really stretching or thinking to understand the why we're doing this.

Then it's around problem structuring and problem solving, this we're going to hit problems, and if we get our heads around those problems in advance, we can have proactive solutions to those. This brings in the notion of really discipline design optimization and design thinking. So the precision in thinking, challenging alternatives in ways to build these solutions to come up with an optimal solution was important. Then taking that design and building it, putting it in place, putting the code, putting this testing, putting the infrastructure, putting all the required backend technology to actually run the solution.

Then you get into the implementation, where it's full cycle, testing, stress testing, failover testing, performance testing, spike testing, security testing, all those parameters, that you really need a well-defined playbook to make sure that you're not going to miss anything critical when you flick the switch and go into production. And then, the final stage, which is often overlooked in situations of complex projects is the operationalization to maximize efficiency and really drive business value out of the investment. So working with a partner that can guide the stages of the project through a successful journey was center to our process.

Gareth Lodge:

Perfect. I certainly recognize that, one of my bosses, and I'm sure this is probably one of those stories we've all heard, is that you get those learning moments from when things don't go to plan. So it's not just being able to do it right the first time. It's what happens if it doesn't go right and that experience and as you say, those war wounds and experience that really make a valuable partner for yourself.

Bruce Duthie:

Yeah, fully agree with that, Gareth.

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Direct Clearer

Gareth Lodge:

So I think one of the really interesting parts of your story is how you've become a direct clearer in Canada, something that is, I think, in living memory for most people, the first time it's been done. So I'd like to kind of really understand a little bit about what you did, why you did it, and of course, how you went about it. So perhaps the starting point is just explaining what a direct clearer is. Clearing systems differ country by country, so explain a little bit about what happens in Canada. And then, I think the story will unfold from there.

Bruce Duthie:

Yeah, absolutely. So at a high level, at the level of the economy within the banking system in Canada, there's not that many banks to start with compared to the US. Now, with that said, within the banking landscape in Canada, there are only 13 direct clearers. That means a bank that has a direct settlement account with the Bank of Canada and has direct access to the payment rails through Payments Canada. And to be able to clear and settle money in kind of near real time directly with the Bank of Canada is a competitive positioning investment.

Simply put, it's a structural change to any business, any bank that actually undergoes that transition from an indirect clearer to a direct clearer. What I mean by "structural," it opens up new opportunities and removes prior constraints that are present and very real as an indirect clearer. You're kind of dependent upon your direct clearer to move your money. By doing the transition to a direct clearer, it opens up new channels that weren't available prior to that transition. Further, it opens up opportunities related to this strategic choices that a bank can make, what types of businesses that are possible, what types of businesses fit within their risk appetite. And it really tries to level the playing field of the opportunities that are present now to being a direct clearer. And from that, a bank can tailor solutions that really align directly with their strategic objectives, as opposed to relying on the risk framework from another bank. So in short and in summary, as much as it is a technological change, it's a structural change to the business as well.

Gareth Lodge:

And so, how did you come to this conclusion? Was it part of the strategy? You realized the opportunities it unlocked? Was it related to the big Payments Canada modernization, so as much as the perfect timing? Or a whole range of factors that got you to the point where you realized you wanted to become a direct clearer?

Bruce Duthie:

Yeah, it's a really good question. We knew, for many years prior to becoming a direct clearer, this was part of our strategic agenda. However, we were constrained by transaction volumes that were originally put in place by Payments Canada, related to the volume of transactions that had to go through the system on a day-to-day basis. With us not having a high presence in the retail banking segment, those thresholds were long out of reach for our business model. We knew those rules were changing. They were coming. Payments Canada was making changes to the thresholds. And so, in advance of that, we developed our business case and our planning and our strategy to actually hit the road running when the regulations changed. So that gave us a time advantage of, I would estimate, 18 to 24 months, as opposed to waiting for the regulations to change and then, starting the project. Now, we took a calculated risk. The decision could have been vetoed, it could have been blocked, could have been delayed, but we were willing to take that calculated risk, based on the upsides of actually being first out of the gate under the new regime.

Gareth Lodge:

Anything you would do differently if you had to do it again or advice you'd give to somebody else who is considering such a move?

Bruce Duthie:

Well, one of the things that we realized going into this opportunity that the last time a bank actually did this was like 35 years ago. So the expertise that was around 35 years ago was very skinny. People that were involved in

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that work have long retired and moved on. So this was kind of pioneering work for new entrants. So one of the things that we consciously did was build very strong relationships with the incumbent direct clearers, with all the players that we have to go through when we went through industry testing and collaboration about file movement and money movement. It's not an easy exercise to go through that process. So we started with the relationship building, with all the current incumbents, and really brought them along the journey with us recognizing that the people involved in the activities with the incumbents, again, weren't around when this first happened. So they were learning as well. So we really tried to create this culture of symbiotic learning and create a new playbook for entrants that would be coming in afterwards.

Cloud Payments

Gareth Lodge:

Many people have, I believe, that the future of payments is the cloud, with so many vendors and banks and other organizations moving, at least on paper, their plans to be cloud enabled, but actual migration has been relatively slow. So I think it'd be really interesting for people listening in today to understand why you chose to move so quickly to the cloud, how you moved so quickly to the cloud, because there's one thing wanting to, another actually managing it. And maybe, are there any lessons that you've learned on the journey to get to cloud from here? If anybody was hesitating now, what would you say to them, in terms of encouragement about moving your payments operations to the cloud?

Bruce Duthie:

Yeah, it's a very important topic related to this type of decision. And one of the things that how we fundamentally positioned the decision to adopt as a cloud first strategy for this was, one, recognizing that a cloud decision is not purely a technological decision. And this was one of the things that I think explained some of the long delays for cloud adoption is because organizations can sometimes take a limited view that cloud computing is a technological solution as opposed to an economic solution and a technological solution. So knowing this going into that, we looked at the business model, recognizing that it's going to scale fast, it's going to require high reliability, high performance, high security, to be able to adapt to various cycles of demands in a dynamic fashion. So the requirements, call it the non-functional requirements for operating in this space, really aligned almost precisely to the overall constructs of cloud computing.

It's dynamic, it's scalable, it's secure, it's higher resilience, meaning that you're not having a room full of servers on-prem. And so, recognizing that the economics and the technology aligned to fit this business case much more accurately than a traditional build out on-prem, the decision to cloud was, I don't want to trivialize this, but it was not a decision, because it was our only viable alternative. Now, I'll just unpack that a little bit, because we did consider what would be the most resilient, what would be the most scalable, what would be the best configuration to optimize return on investment and the overall engineering economics around this decision to make it a profitable and sustainable investment for the company. So that feeds into the pricing strategy, the costing strategy, cost optimization work, I should say, to say, "Okay, when we run this, we want to make sure that the cloud platform that we're using can meet all of those expectations for the current and scale as we expand our footprint into this space," which is precisely, to the whole, again, rationale between cloud architecture versus traditional.

Gareth Lodge:

That makes perfect sense, and I completely agree, how many people just see it as kind of somebody else's tin, as opposed to, on-prem, it's "my tin" and I kind of forget the business implications and all the benefits to it. And so, what were some of the lessons that you learned? Did you have to do any financial re-engineering or the different loads, et cetera? What were some of the less obvious things that you might have learned on your journey?

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Bruce Duthie:

I think that's, yeah, that is a good point you bring up, because one of the things that, when you're going into a utility services, you recognizing that, anytime you turn something on, the meter effectively goes on. Meaning and when the meter's on, you're paying for it. And if you're paying for it and you're not offsetting that up with some form of revenue, it just can quickly increase your overall cost structure. So that's why we had a very good understanding of the engineering economics of how we're building this out to know what should be on and what velocity it should be on, to really understand the costing environment. So when we're bringing in traffic and we're doing our pricing strategy, it actually makes profitable sense.

That is something, again, that is a new discipline for organizations, as opposed to buying technology, capitalizing it, and amortizing it over five years, where the operating expenses, they don't matter that much. They matter, but not as much as they do when it comes to cloud computing. So pulling the financial analysts into the decision-making, pulling in the risk professionals into the decision-making, understanding how to optimize this environment, and that goes back to the partnering decision, understanding how to tune and optimize the cloud environment is essential to make this a viable option.

Gareth Lodge:

I love that kind of turning on and the meter starts running. I think some people will also forget that you have got now the ability to turn it down and kind of pay less when you're not using as much, because volumes kind of change during different times of the day, the weekend, et cetera. So there's some really good advice in terms of understanding the finances, which I think links back to one of your earlier answers. I think, because you know payments are so important to you and your success of the bank, you understand payments as a business. And we are always surprised by how many banks are, well, payments is a cost center, but they don't understand really the costs and the dynamics and the levers of that business. So it makes them very challenging to make a proper investment decision, because you don't know what the uplift is, the downsides, et cetera. So that's really interesting tying a number of those threads together.

Bruce Duthie:

It is a very dynamic environment, and you raised a point of, as you can scale up, you can effectively scale down. And that's kind of the beauty and the art around cloud computing is that, if you see it as much as a platform for growing your business, it's a utility that you can scale very quickly and either up or down to maximize its value contribution to the business model, as opposed to having a fixed asset on site, where effectively, you're amortizing it across its useful life, end of story. You can't really control the depreciation expense year over year, but in the cloud environment, you can have a much closer watch on the actual burn rate and the consumption.

Gareth Lodge:

Yeah, I used to work at the UK ACH, and we used to plan for peak volumes plus 10% five years out. But in reality, 85% of the capacity sat unused for 85% of the time, but we still had to pay for it.

Bruce Duthie:

That's precisely it, and that's why, again, I think you're spot on, as it relates to, and I'll just close this off, is as much as it is a technological breakthrough and solution, it is an economic model. And so, they're two sides of the same coin. And I would encourage that, as organizations, whether it be bank or non-bank, really examine cloud computing as part of their future strategy is see it in that way, not just an IT solution.

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What’s next?

Gareth Lodge:

So I guess the final question today is, what's next? The pace of change of payments is not only accelerating. It's probably accelerating even faster, not just with new demand, but also, new possibilities. And we thought the pandemic had a big impact on payments. Yet, it's accelerating further still. So kind of curious what's on your priority list or wishlist for the next couple of years. And why?

Bruce Duthie:

Yeah, no, thank you for that kind of open-ended question, because it's a big question. And I can give some perspectives and insights on the key themes that are our kind of centerpiece for us defining what is next. And it's adaptability, agility, scale, and resilience. So when we look at that, we can unpack each one of those, kind of ad nauseum, but I'll just kind of touch on the high salient points. We recognize that, to be an effective competitor and a viable contributor to the banking system economy, we need to have a high degree of resilience as an organization. Well, what does that mean? Well, that means that we need to look at our business model and look at it strategically, look at it financially, look at it technologically, and look at it culturally, to understand, "What could happen outside or inside that could introduce a shock to the system and our ability to withstand that shock and restore operations in a smooth and efficient manner?"

We see that the component of payments modernization, coupled with the adoption of advanced technologies, gives us an added layer of resilience to pivot to where the demand for payment services are going, knowing that we're at the driver's seat on what businesses we can enter and/or exit, and recognizing that the technology driving this platform is designed with high reliability. That gives us some assurance on that. Add in the new realities that, prior to 2022, the rate of interest rate changes, over the past kind of four decades, has been relatively non-eventful. So we've been accustomed to living in a zero to near zero interest rate environment.

Now, in 2022 and into 2023, that model has changed radically, to the point where the rate of interest rate increases has been unprecedented since the eighties. This changes the landscape, I think, more significantly than most people understand, because it creates a new operating environment as it relates to the commercialization of products and services as a bank. How do you drive profit? How do you protect your NIM? How do you drive interest income? How do you protect your deposit base? How do you grow your lending book? All these components are now under a new interest rate environment.

Now, an analogy, you could look at this from a non-banking world, and it kind of parallels itself to climate change, where the world, for a long period of time, was operating under a current temperature. And then, when climate change became a reality, what that's doing is it's creating new selection pressures on the planet, that is causing things to adapt in ways that they never were used to adapting to. I think banks and the broader economy is now adapting to a world of higher interest rates. Some companies will perish, some companies will thrive, some companies will kind of limp along, trying to figure out what's next for them.

But we are not underestimating these changes at the macroeconomic level, to making sure that our products and services as a bank are well positioned to continue to service our customers, continue to service our stakeholders, be well aligned with regulatory requirements, as a viable and resilient bank, and really looking out, on the long run, to maintain sustainability and a competitive edge as we compete in this arguably oversaturated environment. So how do you do that? You have to find vectors of differentiation. You have to have products and services that are unique, that are compelling, that are reliable, that are trustworthy, that offer compelling value to the customers that we're bringing those to. And that's why we, kind of coming back full circle, why we see being a payments bank at one of the centerpieces of our strategy is a compelling and differentiated choice that we've made to be that provider in the economy.

And I'll kind of close with saying that, although we are, from a regulatory standpoint, a Schedule 1 bank and a trust and loans company, we see that our role in society is much broader than just providing deposits, lending products, and the ability to move money. We see us as a catalyst for economic growth, for sustainability, for good ethics in what we're doing, to embrace diversity, equity, and inclusion, in our internal strategy, to not overlook the importance of strong leadership and capabilities inside our organization to take these tools and

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new advances in technology and put them to work in meaningful ways. We see our bank as much more than just a bank in the economy, as opposed to a contributor to sustained economic growth. And we look forward to the next steps in this journey.

Gareth Lodge:

That's a great answer. Really interesting, and I think there's so many truths in the answer. In the times of change or kind of more challenging times, generally, those who are embracing it, are understanding it, are generally the ones who are going to succeed. It's going to, unfortunately, for some, have been very tough times, but I think, equally, creates great opportunities for those who recognize them and can grab them by both hands.

Bruce, thank you ever so much for your time today. It's been a fascinating talk. I can sit here, chat to you for many, many hours yet to come. But in the meantime, thank you ever so much for sharing your insights with us and, of course, our audience today for this fireside chat. Thank you.

Bruce Duthie:

It's been my pleasure, Gareth. Thank you again for the opportunity to have this conversation. My pleasure.

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