February, 2024

Payments Sourcing Report

Dutch Banking Insights: How to manage change overload

CGI

Foreword

We are delighted to present our very first report on payments sourcing in the Netherlands. As a global company, in our interactions with Banks around the world, and also in Europe, we see a tremendous challenge for Banks in payments.

This led us to explore in more detail how Banks view this challenge, how they seek to respond strategically and what sourcing approach for their payments processing they consider optimal. The payment leaders we talked to for this report share their views on the optimal sourcing approach to payments, including looking at an increasingly popular option: outsourcing payments.

In this report we hear firsthand about their challenges - the payments change overload - and the necessary strategic decisions they need to make today. We also provide insights from our yearly Voice of Our Clients survey with over 280 interviews with Bank leaders around the world.

We would like to thank our survey participants for their transparency and valuable input. We believe our strongest asset as a global consultancy firm is in listening to our clients and understand their needs, particularly during transformative times. It is clear where the need is today and what needs to happen next.

We trust this report will not only serve as a valuable resource, but also inspire continued dialogue on the future of payments in our interconnected world.

Andy Schmidt
VP, Global Industry Lead, Banking Corporate Services & Global Banking

Arthur Reitsma
Senior VP, Financial Services, Netherlands

Contents

Payments change overload ahead

Executive summary

“Banks need to do more, act faster, adapt quicker to the forces of change and always remain operationally excellent.”

Payments play a crucial role in driving our economies, serving as the lifeblood of transactions and financial stability. We depend on efficient payment systems to facilitate the exchange of goods and services and foster the economic growth on which our economies rely. Payments underpin everything and EU regulators are driving this home.

Banks’ role in payments

As efficient and modern payments enable our economies, any outages are incredibly disruptive and costly. Payments need to be modern, fast, safe, efficient and reliable, every time, all the time.

In an era defined by the relentless march of technological progress, the landscape of financial transactions is undergoing a profound transformation around the world. Adding to the overall complexity of tech-driven change, the European Union (EU) has long made payments the focal area of its modernization agenda, to enable trade and to ensure the key payments infrastructure remains native to Europe.

The onus is on the providers of payments services to make it happen. Banks traditionally manage the payment infrastructure. In payments, they face more pressure to implement regulation and innovate at the same time. They need to do more and act faster to the forces of change while always remaining operationally excellent. It is a huge challenge.

How do the key players of the payments infrastructure deal with this change? How do we keep one eye on our compliance objectives while also pursuing innovation goals? How do we organize payments functions to be efficient and future-proof. Which sourcing model works best and can help meet our ambitious payments goals? How do we remain reliable and ensure safe and secure payment infrastructure at all times? In short, what is the best way forward?

Responding to payments change

For the purpose of this report, we have interviewed 5 of the top 10 Banks in Netherlands. Cumulatively, they constitute more than 50% of the payments volume within Netherlands. We had an interview with Mr. Boudewijn, General manager of Dutch Payments Association, on the payments trends. His position with the Dutch Payments Association gives him a unique perspective of the payments industry as a whole.

Through a series of interviews and follow ups, Banks indicated that the upcoming Instant Payments Regulation and the Payments Services Directive 3

(PSD3) are both expected to impact them the most. The first requires every Bank to receive Instant Payments already from the end of this year.

The payments scope of this report, specifically, was Account to Account payments (A2A). A2A payments are gaining prominence, especially with the advent of Instant Payments, as a cheaper and efficient base for further innovation. Instant Payments enable use cases beyond a 'regular' funds transfer, such as for in-shop and on-line payments. The EU finds this key. Taking this into consideration and the fact that A2A payments are a significant source of cost and effort, the scope of this report is limited to A2A payments only. Therefore, we will refer to it as payments in the rest of this report.

"It is fair to say that all Banks have challenges, but a far greater burden appears to be falling on mid-sized Banks whose core business isn't payments."

A strategic sourcing decision

In pursuing this initiative, we outline the challenges and present the solutions for Banks' sourcing approach. We look at what the optimal response is for Banks to source their payments function and deal with the many demands they face. Due to the very dynamic payments market the sourcing option choice is strategic.

It is fair to say that all Banks have challenges, but a far greater burden appears to be falling on mid-sized Banks whose core business isn't payments. For these Banks the payments changes drain the business focus from their competitive services; many tell us that payments is not viewed as a differentiator. Furthermore, competition in this space is growing. The past few years have seen the rise of Fintechs and challenger Banks in the payments space, characterized by cutting edge technology and an agile mindset. This is leading to new products and services reaching the market in much shorter time frames.

While this is a welcome development, it has pressured traditional Banks to innovate and compete with innovative payments offerings of their own. Above all, it is clear that a more strategic approach to payments sourcing is required to stay on top of the changes going on in the industry today.

There are a few key findings that emerge from the survey. Firstly, Banks must start to look at the impact of the new Instant Payments regulation now and allocate budget while considering the impact on the 'classic' SEPA Credit Transfer volumes. Limited time remains and the impact is significant. Secondly, Banks should review their strategic approach to payments and make a clear decision on what type of Bank they want to be in payments. This can't be a half-hearted decision. Finally, as outsourcing is a clear trend, Banks should go out and engage with the market to drive better standardization; this enables economies of scale and increases benefits.

We hope this report serves as a discussion starter and food for thought for the Dutch Banks as they respond to these payments market challenges.

Change overload?

Managing a changing payments landscape

EU plans to modernize payments and establish a level playing field among the various industry players has shaken up the sector. Pursuing this goal has led to a rising number of compliance and industry initiatives throughout Europe, and increased pressure on all Banks. Our conversations with Banks reveal they are overburdened and struggling to adhere to these requests.

Compliance Initiatives

- Instant Credit transfers in Euro — Q4 24
- Payment Service Directive (PSD3) — Q3 26
- Digital Operations Resilience Act (DORA) — Jan 25
- Central Electronic System of Payment Info (CESOP) — Jan 24
- Verification of Payee - EPC

Industry Initiatives on X-Border

- ISO 20022 Migration — Nov 25
- SWIFT GPI — Live
- SWIFT GO — Live
- Immediate X-Border (IXB) Pilot
- One-leg-out SCT Instant — Nov 23

Industry Initiatives within SEPA area

- SEPA Payment Account Access (SPAA)
- European Payments Initiative (EPI)
- SEPA Request to Pay (RTP) — Live
- EU Mobile wallet interoperability

Others

- Digital Euro — 26?27?

Compliance and industry initiatives in payments – EU focus

Market trends

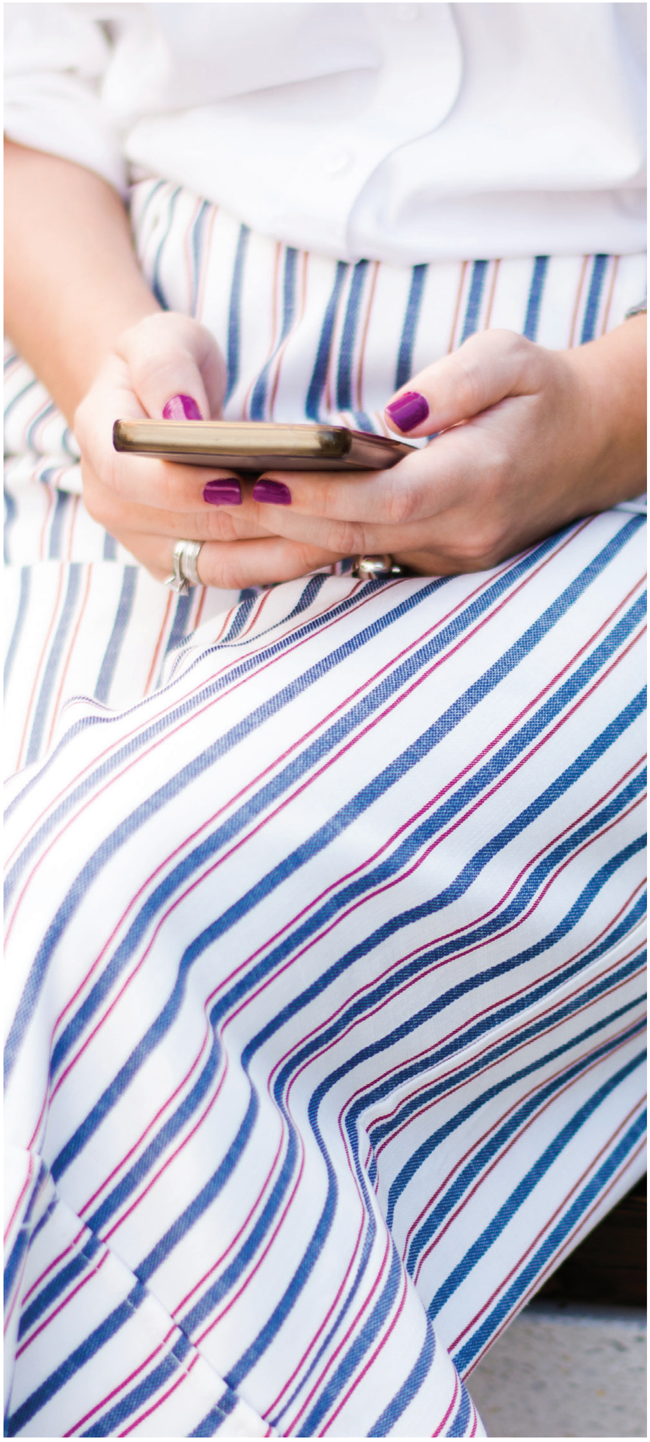
“Banks have been overly dependent on interest income for their profitability in payments and not enough on the fees income.”

Margin pressure on Banks

Banks with a presence across multiple geographies are simultaneously rationalizing the application landscape. Owing to its size and complexity, this takes up a significant portion of their IT budget; leaving little room for innovation. Also stiff competition from ‘agile’ challenger Banks and Fintechs have brought further margin pressure on Banks. Mid-size Banks have an even greater challenge and are stretched to just keep up with regulatory changes.

A study conducted by the Dutch Payments Association in early 2022 found that larger Banks in Netherlands have collectively incurred an annual loss of EUR 570 million before tax on payments processing. Recently that has changed. The rise in net interest income for Banks has led to substantial windfall for Banks. The Dutch Central Bank expects that with the same method of calculation, Banks in Netherlands would have a surplus of EUR 1 billion for 2023 from payments processing. The margin will fade again when interest rates go down as is currently expected.

Mr. Boudewijn, General manager of Dutch Payments Association, says that on average payments service margins for Banks have probably switched to positive again due to higher interest rates. That was not the case for the last few years due to fees not covering the



costs and as a result Banks have raised their account package fees. The current positive turn however does not solve the structural problem of profitability of payments. The current upside gives them a window of opportunity to invest in bringing down the costs of payments and one of the ways to do it is by having the right sourcing structure.

In our survey, we find that most of the Banks have cited Instant Payments and PSD3 as the most significant transformation changes and the most complex to achieve.

"Increasing dependence on a few non-European payments providers is not desirable for the strategic autonomy of the EU and also leads to less competition in this space."

Instant Payments

There is a 'long tail' of mid-sized Banks in the Netherlands that are yet to implement the next stage of evolution of Credit Transfers: Instant Payments. The real-time, 24/7 nature of Instant Payments aligns seamlessly with today's digital world. With the new EU Instant Payments Regulation expected to come into force in the first quarter of 2024, Banks in the Netherlands have a deadline of nine months to address the first impact – the ability to receive Instant Payments.

Mr. Boudewijn says: "This legislation will have a substantial impact on the long tail of the smaller Banks that have not yet implemented Instant Payments. Even the Banks that have already implemented Instant Payments would require changes in their process and would need to tune their offering to cater to the anticipated large cross-border Instant Payment volumes. Fortunately, we have lessons learnt from the first wave of implementation of Instant Payments, but timelines are very short and for our Members some detailed interpretations of the Instant Payments Regulation towards operational practice are ongoing. We are ready to facilitate this."

As cited by one of the survey participants, the real time, 24/7 nature of Instant Payments is the major reason why it is difficult to build. Traditional core banking systems and payments engines were not built for such quick processing times and many have a scheduled 'End of day' process. Banks would need an upgrade on the technology and at the same time invest in 24/7 operational processes as well. With a higher uptake of Instant Payments, the payment volumes based out of Instant Payments will also rise. For example, wider availability of Instant Payments could act as a catalyst in moving the Point Of Sale (POS) transactions also on the Instant Payments rails.

Mr. Boudewijn says that increasing dependence on a few non-European payments providers is not desirable for the strategic autonomy of the EU and also leads to less competition in this space. From a geopolitical perspective, the European Commission strives towards a more account-based infrastructure to provide European alternatives to decrease dependency on card-based non-European solutions available today.

“Data is the ‘crown jewel’ of the Bank and it would only be fair that the Banks are adequately compensated for building the infrastructure to share it with other service providers.”

Open Banking

Increasingly, Banks see that there is a ‘data dividend’ to be realized from open technologies. Along with Instant Payments, Banks have also identified Open Banking as another area that will have a significant impact. The lack of API standards in PSD2 resulted into several competing standards in the last few years. Even amongst Banks that use the same standard, there are deviations in terms of the implementation by the Bank. This has been a long standing challenge.

The European Payments Council (EPC) initiative on the optional SEPA Payment Account Access (SPAA) addresses it to an extent by defining a scheme that governs the premium API’s that are built on top of the mandated PSD2 API’s. As premium API’s, these API’s will augment the use cases supported by PSD2 API’s. Apart from standardization, this initiative also addresses the issue of interoperability amongst Banks by setting up a framework for fair distribution of the value and risks across participants. Within this framework, Banks can charge a fee to the Third Party Provider (TPP) for access to these API’s. If applied well, this model makes it attractive for a wider participation amongst Banks and eventually for TPP’s.

In the words of Mr. Boudewijn, data is the ‘crown jewel’ of the Bank and it would only be fair that the banks are adequately compensated for building the secure infrastructure to share it with other service providers. A scheme like SPAA sets the new standards for interoperability and standardization amongst banks and TPPs and can thereby set the foundation for data sharing arrangements in Open Finance.

The update to the Payment Services Directive, called PSD3, also refers to a new framework for Financial Data Access (FIDA). This framework regulates access to customer data beyond payments; with FIDA a customer can share its data related to financial products and services with innovative service providers. The products and services range from loans, savings, investments, pensions and insurance. PSD3 builds on the initiatives from PSD2.

The exact timelines implementing the PSD3 and the new Payment Services Regulation (PSR) aren't established yet. But it is assumed that it will be in effect some time in 2026. Note that the largest cost item for implementing PSD2 was on API development. Banks in the EU are estimated to have spent EUR 2.2 billion on its development. With the new framework for Open Banking, Banks would now need to have a strategy on how it can turn its investments into a profitable proposition.

Other initiatives

International payments has emerged as a geopolitical focal point. This is underscored by the G20, wherein International payments was made a priority. Faster, cheaper and transparent international payments can benefit economies worldwide. Triggered by the G20 aim, several initiatives have surfaced to support it, such as SWIFT GO, EPC One Leg Out Instant Credit Transfer scheme, IXB and Nexus.

More recently, the European Payment Initiative (EPI) is designed to leverage Instant Payments for P2P payments and E/M Commerce on a European level. Moreover, the EPI initiative provides a framework to transfer payments using mobile numbers instead of lengthy IBANs.

The SEPA Request to Pay scheme is expected to boost the services that can be offered based on payments. The optional scheme has been live since 2021 and it has seen a slow adoption rate. However, recently promising use cases are being investigated, for instance related to managing failed SEPA Direct Debits.

Historically, the way people make payments has changed with technology. Money itself has changed from sea shells to coins to paper and more recently digital. Similarly, the advent of new technology like Blockchain and Generative Artificial Intelligence (Gen-AI) will also change the way we do payments. Blockchain technology has already triggered concepts such as Central Bank Digital Currency's (CBDC) and Stablecoin's. CBDC's are already live in a few countries and the EU is contemplating to implement its own CBDC – Digital EURO. Generative AI will revolutionize the back-office tasks and training of payments professionals.

Bank’s strategic response

Sourcing approaches and considerations

It is a complex process for Banks to decide on their best sourcing strategy. This should start with deciding what type of payments Bank they want to be to define the payment changes that are necessary for them. We identified three key steps in this process and this guided our conversations with the Banks.

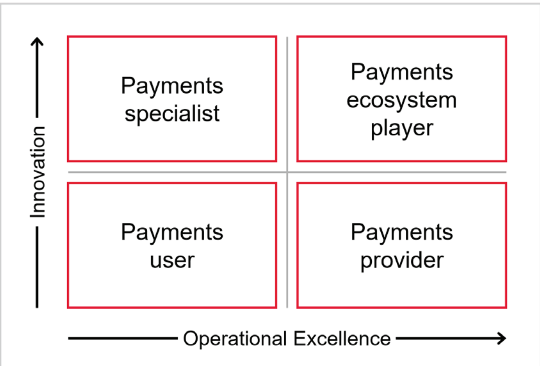
“Banks that have outsourced payment applications find it easier to manage the pace of change in the payments industry.”

A three-stepped approach to deciding the optimal strategy for delivering the Bank's payments function.

STEP 1: Payments strategy: a Bank's ambition in payments

In this changing and uncertain environment, it is an imperative for Banks to make clear and bold business decisions on what type of Bank they want to be in payments. For example, do they want to focus on innovation or be on par with the market, or offer a large network cost efficiently.

We categorize the Bank's payments strategy into four types, along the axis of innovation and operational excellence (see graphic below). These types might look somewhat simplified, but are fully recognized by the Banks surveyed and will drive important conclusions.



Payments strategy options for a Bank

- The 'Payments user' is a Bank that considers payments as a non-competitive service. A compliant payments service that is in line with the country or regional norm is fit for purpose. Typically mid-sized Banks whose core business is not payments characterize themselves as a Payments user. This was confirmed by our survey.
- A 'Payments specialist' seeks to provide leadership in payments (value add) services. Focus is on providing flexible and state-of-the-art services. Costs are less important.
- The 'Payments provider' seeks to process a large number of transactions for their own Retail and Wholesale clients and optionally grow by attracting volume from other Banks. The Bank focuses on the operations/technology infrastructure to process transactions in a cost efficient manner and leverage their large network. Typically the larger Wholesale Banks tend to fall into this category as confirmed by our survey.
- A 'Payments ecosystem player' is an outlier, focusing on scale and innovation and realizes this through an ecosystem of providers.

STEP 2: Identifying future key payments changes

Evaluate what future key payments changes are required based on the market trends identified in Chapter 2.

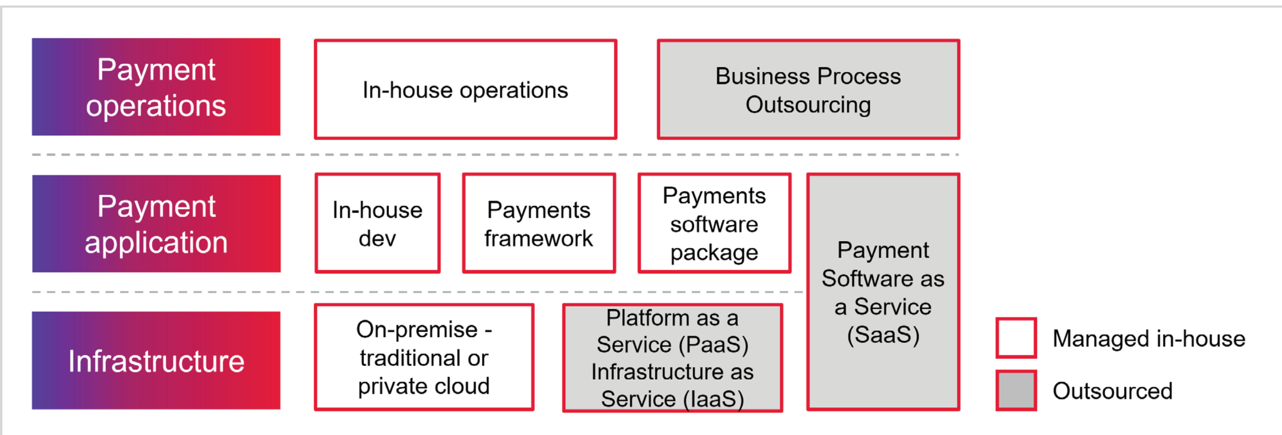
STEP 3: Sourcing options and considerations

Decide on the optimal sourcing strategy. Many options are available and we describe the options and considerations, including outsourcing, which is on the rise.

When looking at how to source payments optimally, the Bank has different options to consider. The Bank's payments function can be divided into three layers: payment operations, payment applications and the infrastructure. For each layer the bank can decide to source it in-house or outsource it (see figure sourcing strategy options).

From our survey, we find that the Banks want to keep the operational processes in-house. The reason cited is that the Banks understand their customers better and want to own this interaction. However the applications and infrastructures are more likely candidates to outsource.

Sourcing strategy options per layer

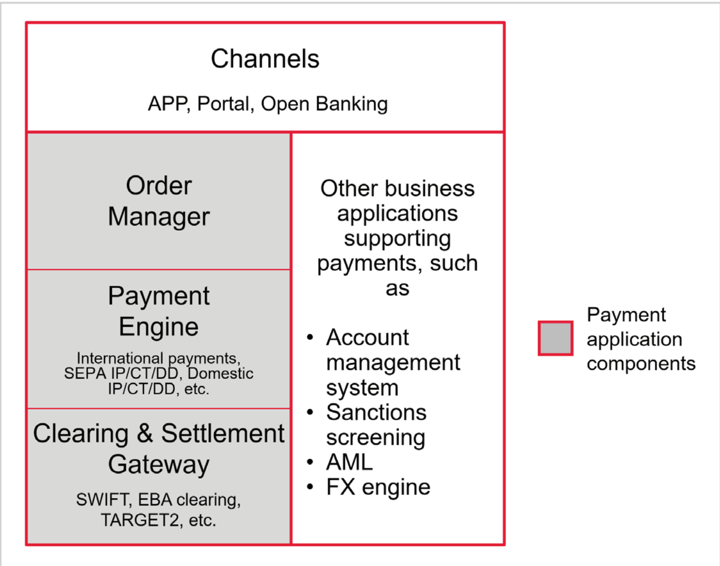


Sourcing strategy options

“Outsourcing the application layer guarantees them compliance without impacting the timelines of other planned improvements.”

Payment application layer

The payment application layer consists of the applications that enable payments processing, from managing client payment orders, to processing and sending it via gateways to the different payment market infrastructures. The payment application layer interacts with the other Bank’s domains and their applications. Depending on the size and type of the Bank it can be a complex architecture, but the graphic below provides a market standard for a modern and componentized set-up, that will greatly support a Bank’s agility and efficiency.



Payment architecture components

“The modernization of the payment application architecture is typically required to implement a sourcing option successfully and beneficially.”

Mid-sized Banks may not have a separate Order Manager and/or have their payment engine integrated into their core banking system. For large Banks, the payment application landscape may be more complex e.g. with multiple payment engines.

Establishing an Order Manager and standardized interfacing between the payments domain and the other domains within the Bank, e.g. via APIs, will drive flexibility and ease of implementing different sourcing options. The modernization of the payment application architecture is typically required to implement a sourcing option successfully and beneficially.

Banks can decide to implement in-house options, via buy or build, or alternatively, the Bank could decide to acquire a payments framework that provides a functional and technical foundation as a starting point on top of which the Bank can develop its desired application. Another option is to outsource. As confirmed by our survey, mid-sized Banks tend to look at outsourcing, the large Banks are more inclined to keep them in-house.

When considering outsourcing the Software as a Service (SaaS) model is a preferred option according to our survey participants. The advantage of this model is that the Bank does not need to focus on operations and maintenance (including compliance). The Banks can therefore focus on its core business. Ideally, it is best suited for Banks that have a long-term strategy of a Payments user. A SaaS model comes with its own infrastructure and operations (for IT-related activities).

From our survey, we found that Banks that have outsourced payment applications find it easier to manage the pace of changes in the payments industry. One of our participants cited that outsourcing the application layer guarantees them compliance without impacting the timelines of other planned improvements.

This is in line with CGI’s Voice of Our Clients. The survey of 2023 finds that 17% of European Banks are planning to use SaaS (managed services) for their banking applications (i.e. not specifically payments) within two years, up from 4% that are currently using this sourcing model.

Payment infrastructure Layer

The payment infrastructure layer consists of the infrastructure resources needed to host the applications. Mission critical applications like payments need the infrastructure layer to be highly resilient. Development of 24/7 Instant Payments and the growth of electronic payments have put further pressure on resiliency.

Electronic payments are now a utility service and an outage will instantly impact customers, if several Banks fail, the overall economy is affected. At the same time, the advent of cloud computing has enabled Banks to implement new infrastructure rapidly and scale up/down hourly based on the demand. If the application is built specifically for cloud (i.e. cloud native) then many of the infrastructure management activities can be automated.

For example, scaling up just for the end of month corporate batches processing surge will ensure that the performance will not be impacted. Using the advantages of the cloud, especially the Platform as a Services offerings with its high automation and scaling capabilities, can additionally provide interesting cost advantages (50% to 75%).

CGI's Voice of Our Clients 2023 finds that Banks considering using cloud is significantly on the rise. 39% of the Banks plan to adopt cloud over the next 2 years, up from 16% that are using it now.

"From our survey, we found 'Payments users' are highly likely to consider outsourcing, or already have done so. For such a Bank, building payments capability does not help give itself a significant competitive advantage."

Outsourcing of payments

Our survey finds that the growing list of compliance initiatives is one of the major drivers for outsourcing. By outsourcing payments, the Banks are free to allocate their scarce resources towards their core business model. This is particularly beneficial if the Bank sees itself as a 'Payments user'.

Understandably, from our survey, we found that Payments users are highly likely to consider outsourcing, or already have done so. For such a Bank, building payments capability does not guarantee a significant competitive advantage. On the other hand, a (SaaS) outsourcing service provider can tremendously unburden the Bank by delivering payments products and changes with economies of scale in a timely manner. Other reasons for outsourcing given by Banks were: upgrading technology and freeing up resources for innovation.

Furthermore we find that legacy architecture is cited as the biggest impediment to outsourcing. As mentioned above many payment application components tend not to have clear demarcation of capabilities assigned to them. Therefore, migrating them to an outsourced service requires a rejig of functionalities served by these components. It is critical to design and execute this well, not only for the first service to be outsourced, but also assessing potential future next (outsourcing) steps as well. Banks should get (external) expert support, when in doubt. Other challenges that were mentioned were: organizational challenges and capacity, lack of a suitable outsourcing provider.

When queried about the type of outsourcing service providers, there was no clear preferred option. Independent payments processor and SaaS providers were often mentioned, followed by Bank co-owned provider and Banks. One Bank indicated that they are considering future payments insourcing services. Please refer to the Appendix for a detailed description of the types.

As described earlier, the Instant Payments Regulation, will mandate all Banks to implement significant changes, with a green field implementation of Instant Payments being most impactful. In the latter case, it is likely that this will drive (mid-sized) Banks towards outsourcing. When doing so it will be important to also review the sourcing of the regular (SEPA) Credit Transfers. With the Instant Payments Regulation aiming it to make them the new normal, the Credit Transfer is expected to decline significantly in the next two years, with a risk of low volumes while incurring the same or similar costs.

Towards Outsourcing

4 key considerations for Banks

"Governance is essential for maintaining order, achieving objectives, and addressing both our needs as a client (including regulatory obligations) and the needs of our supplier."

Outsourcing of payments has been growing with Banks in the Netherlands with varying implementation models and providers. As you embark on this journey, it is critical to know what is out there and the optimal characteristics of an outsourcing partner.

Functionality and Technology

If the Bank chooses to outsource then it is important to ensure that the outsourcing provider offers the required functionality 'out-of-the-box'.

From our survey, we find that the Banks show a preference for an outsourcing partner that can process all the payment products (within the scope of this survey such as SEPA Credit Transfers, Instant Payments, Direct Debits, International Payments, etc..). There is a considerable overlap of functionality between these payment products and it is expected to be advantageous to have it processed by a single vendor rather than multiple vendors.

With a decision to outsource, the Bank is relying on the outsourcing partner to provide modern technology to support payments processing. We feel it is important to assess the architecture and the technology platform on which it is run. If it isn't built on modern technology stack then the Bank will not benefit on costs and agility in the long run.

Transformation

As mentioned earlier in the report, legacy architecture was quoted as the most significant impediment to outsourcing. A decision to outsource has a sizeable impact on the architecture of the Bank. This transformation should be taken as an opportunity to adapt the internal architecture of payments within the Bank. Such a re-structure helps in facilitating a progressive transformation/migration and avoids a big bang approach with its associated risks. It is also important that the outsourcing providers offer a good integration framework, i.e. in case one product has been outsourced (e.g. SEPA Instant Payments) then it should be subsequently easier to outsource other product such as SEPA Credit Transfers. If the payments processing is an integral part of the Bank's core banking application (that is not modern and componentized), 'extracting' the payments processing for outsourcing purposes might not yield a positive business case due to integration costs.

Trusted Partner

Selection of an outsourcing partner necessitates a comprehensive due diligence. It raises the questions such as the following: Will the outsourcing provider remain a solid partner in the coming years? What is its track record in payments? Does its management and staff have the required maturity and expertise? What is their ownership structure, vision and projected profitability? Do they offer Continuous Integration/ Continuous Delivery? Do they have the required certifications and assurances such a ISAE 3402? What off-boarding process is offered when the service needs to be terminated?

From our survey, governance was cited as one of the key factors in choosing an outsourcing partner. One participant cited that: “Governance is essential for maintaining order, achieving objectives, and addressing both our needs as a client (including regulatory obligations) and the needs of our supplier”. Should the outsourcing partner offer the Banks a share in the operation – or be owned by them – then it can provide an interesting form of control over the payments service, strategy and joint benefits.

“Outsourcing can support them to manage the implementation of the regulatory roadmap and other industry initiatives, in line with EU objectives.”

Client exceptions/ value added services

The payments products in the scope of this report are relatively standard but there still might be some variations in terms of how a Bank addresses exceptions. Such as, for example, the supported code words in a cross-border payment. There might also be some extra value added services that they might give to their clients. This is especially true for Wholesale Banking clients. The Bank should check on how these exceptions and value added services can be applied by the outsourcing partner. This transformation also gives the Bank a chance to re-connect with their client groups and re-look at the product features and value that they still would like to provide.

In our view, the share of Banks that chose outsourcing of payments (via SaaS), will only rise in the years to come. This would be especially true for Banks that see themselves as a Payments user. Outsourcing can support them to manage the implementation of the regulatory roadmap and other industry initiatives, in line with EU objectives.

We believe that the relatively standardized back-end components such as the Payment Engine and Clearing and Settlement gateways are the first candidates for outsourcing. On the other hand, client facing channels and supporting mid-office applications such as an Order Manager are key to customer interaction. We believe that Banks probably want to own this interaction as they understand their customers' need and are in the best place to continually improve it.

Amongst the outsourcing provider models, we believe that that the Bank co-owned payment processors is an interesting option to consider next to the other providers already on the market. The Shared Service Center model can bring in efficiency for Banks and a comfortable degree of control (please also refer to 'Denmark and Outsourcing' case study).

Case study: Denmark and Outsourcing

Long term support for a competitive Banking landscape

In Denmark the Banks have a long history in outsourcing. Many of the Banks have outsourced their core Banking applications and infrastructure to one of the three providers: BEC (18 Banks), Bankdata (8) or SDC (22 in Denmark). These providers are Bank-owned. Only a few of the larger Banks are not in this arrangement. The services provided are in the domain of core banking (including payments, loans, savings), capital markets, governance and different supporting functions.

What interesting lessons can be drawn in the light of Bank outsourcing and payments? Firstly, the prevailing sentiment in Denmark is that outsourcing services have enabled the growth of a diverse and competitive banking landscape, whilst ensuring resilient processing. Concentration risk has been limited because of the presence of multiple providers and large Banks are out of this arrangement.

These providers are Bank owned and its governance has contributed over the years to an overall stable and compliant service, whilst providing Banks economies of scale. Agreeing to future roadmaps has not always been easy: it is hard to avoid in a multilateral governance environment. In the light of payments outsourcing the Danish outsourcing arrangements offer food for thought. Supporting Banks with a common compliant service will help the Banks to focus on their competitive edge.

Outsourcing service providers

Over time, we have seen multiple providers on outsourcing emerge with different governance models, such as Banks, Bank-owned, independent payments processors and software providers. This trend has also led to the European Banking Association to publish the Guidelines on outsourcing arrangements in 2019, that provides a clear and upgraded framework for all financial institutions.

Additionally, with the advent of cloud and APIs a growing number of software providers have started offering outsourcing services in a SaaS model.

We see no clear standarization of services and integration as well as no emergence of a clear market leader.

From our survey we find that when Banks consider outsourcing then scope encompasses all types - from SEPA Credit Transfer, Instant Payments and Direct Debit to International Payments. With the mid-sized Banks looking for standardized services it will be important that the ‘standard’ is understood and offered by providers. This will drive economies of scale and support the Banks to execute on the EU’s payments strategy. The Banks and providers market should engage on this.

Conclusion

Time to act

"It is now more important than ever before to have a well-defined payments strategy that drives the long term vision of the Bank."

Payment leaders know that as the industry undergoes fundamental change, the next decisions they make around payments are critical. The Instant Payments Regulation is a high impact change; and on top of it more innovation will follow. It is more important than ever to have a well-defined payment strategy that drives the long term vision of the Bank.

The huge number of changes in (A2A) payments, now and in the future, is demanding Banks to make sharper choices about their response. The insights discussed in this report - and the contributors - point to a growing sense of urgency. Resources are being stretched because of the budget, effort and management focus are being dedicated to both regulatory compliance initiatives and innovation at the same time. This is the unambiguous feedback from Banks surveyed and from others we interact with regularly.

Outsourcing of payments is expected to grow. As payment outsourcing providers grow their business a form of market standard and an increasing sense of trust will follow. That is certain to happen. Collaboration is another alternative where banks come together to provide a specific and common service. This is not uncommon in the banking world, but competition concerns should be considered. A co-owned solution could foster control of the Bank's roadmap and destiny. For this to happen the market typically needs a high impact business event for many, such as the incoming Instant Payments Regulation and/or the expected demise of the 'classic' SEPA Credit Transfer with large cost implications.

From our survey and discussions with the Banks we recommend the following key actions for payments leaders:

Recommendation 1

Assess the impact of Instant Payments Regulation now

If yet to start, Banks should immediately start the impact assessment of the Instant Payments Regulation now and allocate budget. Limited time remains and the impact is significant. The Dutch Payments Association has identified different implementation aspects that still need to be clarified. Banks need to take into account that due to the regulation and its ambition the volumes of 'classic' Credit Transfers are likely to drop significantly in the next two years and would lead to higher cost levels (per transaction). Therefore, Banks need to take into account Instant Payments and 'classic' Credit Transfers when they consider their sourcing options.

Recommendation 2

Be prepared, respond with a clear payments and sourcing strategy

Bank payment leaders interviewed for this report know that as the industry undergoes a fundamental change, the next decision they make around payments infrastructure is critical to their mission. Our discussions found that many Banks were already reviewing their strategic approach to payments with the payment outsourcing (SaaS) option being considered by many, especially the mid-sized Banks. A clear decision needs to be made on what type of Bank they want to be in payments. Based on this they then need to assess the impact of change and decide on the best sourcing options. Many options are available. The trend is towards outsourcing of applications and/or migrating the infrastructure to the cloud.

Recommendation 3

Drive standardization in payments outsourcing

Outsourcing is a clear trend. Most mid-sized Banks are considering it or have already implemented it. Market implementation practices still need to develop further. Standardization on the level of payment function and integration would make it easier for (mid-sized) Banks to outsource and benefit from economies of scale. Banks should actively engage with the market on this. This would also address the concern voiced about the governance of the services roadmap.

Contact us for further information

Appendix

Regulatory push to make the SEPA Instant Payments ubiquitous

In our survey, we find that most of the Banks have cited Instant Payments as the most significant transformative change and the one that is most complex to achieve. Instant Payments are the next stage of evolution of Credit Transfers. The real-time, 24/7 nature of Instant Payments aligns seamlessly with the today's digital world. The SEPA Instant Payments scheme was launched in 2017. It came with a solid promise of being a modern building block (also called 'rails') on top of which many new payments services can be developed.

As the scheme was optional and the investments were substantial, the uptake in most countries was gradual. In May 2023 14% of the EU Credit Transfers were Instant Payments. Payments products benefit from network effects and if there is no widespread European adoption then PSP's will not see the benefits of investing in Instant Payments. On the other hand, adoption by Banks and users will create a positive feedback loop that will fuel further rapid adoption. The benefits from Instant Payments can only be fully realized if Instant Payments are the 'new normal'.

In this context, It is expected that this new Instant Payments Regulation will come into force in the first quarter of 2024. Thereafter, Banks will have a deadline of 9 months to be able to receive an Instant Payment in EURO and 18 months to be able to send an Instant Payment in EURO.

Key problem drivers for adoption	Solutions to the identified problem in EU Instant Payment regulation
Insufficient incentives for PSPs to offer euro Instant Payments (supply-side driver) →	PSPs providing a regular Credit Transfers service should be mandated to receive and send Instant Payments (near term within timelines provided)
Dissuasive transaction charges for Instant Payments compared to alternative payment means (demand-side driver) →	PSPs should not charge more for Instant Payments in euro than for regular Credit Transfers in euro
High rate of rejected Instant Payments wrongly identified as involving persons on EU sanctions lists (supply-side driver) →	Sanctions screening by PSPs should be in the form of very frequent checking of clients against EU sanctions lists (as is already done in certain Member States for domestic payments), rather than for each individual transaction
Payer concerns about security of Instant Payments (demand-side driver) →	PSPs should offer a service enabling customers to be notified when a mismatch is detected between the payee's name and International Bank Account Number (IBAN), as supplied by the payer

Source: EU Instant Payments Regulation

Key timelines for implementing functionalities post the regulation comes into force for Credit Institutions in the eurozone

+ 9 months	+ 9 months	+ 18 months	+ 18 months	+ 9 months
Charges should be equal or less than for regular SEPA Credit Transfers	Receiving of Instant Payments in the eurozone	Sending of Instant Payments in the eurozone	Verification of Payee inside eurozone	Harmonized sanctions screening procedure

The Instant Payments Regulation is expected to come into force in Q1 2024

Impact of this regulation on Payments Service Providers

Furthermore the PSPs need to offer the possibility for corporates to initiate Instant Payments in bulk, in case already offered for regular Credit Transfers. For all PSPs it is expected that the number of Instant Payments will increase, in line with the aim of the regulation, and the payment infrastructure will need to be sized accordingly. Additionally the management of the Bank's liquidity will need to be adapted to strike a balance between the cost of idle liquidity and the risk of rejected Instant Payments within the context of real time and 24/7. The sanctions screening and KYC process will need to change to meet the requirement for a daily check of its customers against the sanctions lists. Another area of impact will be the mandatory Confirmation of Payee. In the Netherlands a well working solution for this is available and from the European perspective the EPC will be releasing a Scheme for it called validation of payments.

When SEPA Instant Payments becomes mandatory the regular SEPA Credit Transfers volumes are expected to decrease sharply. Banks that have not built the SEPA Instant Payments and Credit Transfer on the same technical platform may be left with significant costs for processing very few 'classic' Credit Transfers.

According to the impact assessment report on Instant payments carried out by European Commission, the cost per transaction for 'classic' Credit Transfer is comparable with that of an Instant Payment. Nevertheless, the initial investments will be sizeable for Banks that do not have Instant Payments capability yet.

As the impact of Instant Payments will be significant for many Banks, with the first deadline of the Instant Payments Regulation end of year, Banks should assess the impact and solution options now.

Looking forward, with a higher uptake of Instant payments, the payment products based out of Instant Payments will also rise. Wider availability of Instant Payments would very likely act as a catalyst in moving the POS transactions also on Instant Payments. The pan-European nature of Instant Payments will help in taking a share of the non-cash transactions from the International cards network. Switching rails from the traditional Credit Transfers to Instant Payments would open up newer developments in the market. In many ways, it will set the foundation for the further investments for Banks.

Types of outsourcing providers

Over time, we have seen multiple models on outsourcing emerge. Below are the most prevalent outsourcing models for payments.

Banks with insourcing capabilities

Over the years Banks have undertaken substantial investments in upgrading their payment capabilities. Banks within Europe, for example, have invested in the SEPA program and its subsequent upgrades for more than a decade. More recently, Banks have invested in the PSD2 program and the ISO 20022 migration. Additionally considerable resources have gone into building a robust regulatory compliance around AML/CFT. For Banks with presence across multiple geographies, the costs of meeting these upgrades in different geographies is even higher. These costs are further compounded for Banks that have not rationalized their application landscape.

Some Banks have developed these capabilities by leveraging modern technology in such a way that they are capable of handling substantial transaction volumes and at the same time flexible enough to seamlessly integrate new functionality. Such Banks find themselves presented with a unique opportunity to use their existing payments infrastructure to in-source payments from other Banks. At a very basic level, this covers the indirect participant services.

The fact that the payments are processed by another Bank may give the outsourcing Bank an assurance that the regulatory requirements are addressed. However, when the insourcing Bank has an outage, the outsourcing Bank will want the correct priority for its payments volumes. Also confidentiality will be a topic of concern.

For Banks that are insourcing payments, it only makes sense to do so if the volumes of payments that it intends to insource (and associated revenue) is substantially large to bring down the cost per transaction.

Independent payment processor

In this model, an IT service provider provides payments services to the outsourcing Bank (as SaaS). Generally, the payments processor is a specialist in the payments processing and has its own product with which it meets the requirements of the Bank.

This model is relatively less stable for a Bank due to its overdependence on the vendor. A change in the business model or even an acquisition at the vendor can impact the long term strategy for the company and therefore impact the Bank. Such a set-up requires sound governance processes at the vendor to ensure that Banks have a say in their product roadmap.

The outsourcing Bank would want to ensure that it aligns with their needs. Bank would also need to have oversight over the regulatory requirements.

On the other hand, Independent payment processors are specialists in their area of payment processing and therefore would bring in feature rich products and services.

Bank co-owned payment processor

In this model, a Bank co-owned payment processor is set-up as a shared service center to process payments on behalf of the Banks.

It is generally built in partnership with the Banks and would therefore require a lot of coordination between Banks. It is relatively difficult to set-up considering the conflicting interests of the Banks. However, if set-up then it gives a long term service that is fully compliant with the regulators. Banks have a say in the future roadmap of the shared service. With the right governance, it can bring stability and cost efficiency. However, since it is a co-owned by multiple Banks, the decision making might be slow and agility may be a concern.

Software service provider

In this model, software vendors offer their (cloud native) payments software as SaaS on the cloud. This model is generally served by traditional payments software solution providers that have gradually transitioned to provide their software solution in SaaS mode. They have an excellent track record in software delivery. Similar to the independent payments processor, this model also needs strong governance to incorporate the needs from the Banks into their product roadmap. Alignment between the Bank and the SaaS providers can prove to be challenging.

The cost of development is shared across the clients of the SaaS provider and therefore more cost efficient. The SaaS provider though are required to comply with stringent guidelines for example provided by EBA.

References

- European Commission, Payment services: revised rules to improve consumer protection and competition in electronic payments, June 2023 [online via https://ec.europa.eu/, accessed on 22nd Jan 2024]
- Euro Retail Payments Board (ERPB), Report of the Next Phase of the ERPB Working Group on a Single Euro Payments Area (SEPA) Application Programming Interface (API) Access Scheme, June 2021 [online via https://www.ecb.europa.eu/, accessed on 22nd Jan 2024]
- European Commission, A study on the application and impact of Directive (EU) 2015/2366 on Payment Services (PSD2), Feb 2023 [online via https://op.europa.eu/, accessed on 22nd Jan 2024]
- European Council, Final compromise text on Instant Payments, Nov 2023 [online via https://data.consilium.europa.eu/, accessed on 22nd Jan 2024]
- European Commission, Impact assessment report on regulation amending Instant credit transfers in EURO, October 2022 [online via https://eur-lex.europa.eu/, accessed on 22nd Jan 2024]
- Dutch Payment association, McKinsey & Company, Study into the costs and revenues of payment services for financial institutions 2021, October 2022 [online via https://www.betaalvereniging.nl/, accessed on 22nd Jan 2024]
- Guidelines on outsourcing arrangements, European Banking Authority, February 2019, [online via Guidelines on outsourcing arrangements | European Banking Authority (europa.eu), accessed on 22nd Jan 2024]
- Statistic on % of SEPA instant credit transfers (SCT Inst) in euro compared to conventional SEPA credit transfers , ECB May 24 2023, [online via https://www.ecb.europa.eu/paym/intro/news/html/ecb.mipnews230524.en.html, accessed on 22nd Jan 2024
- CGI, 2023 Voice of Our Clients: Corporate & Transaction Banking, 2023 [online via https://www.cgi.com/, accessed on 22nd Jan 2024]

Insights you can act on

Founded in 1976, CGI is among the largest IT and business consulting services firms in the world.

We are insights-driven and outcomes-based to help accelerate returns on your investments. Across hundreds of locations worldwide, we provide comprehensive, scalable and sustainable IT and business consulting services that are informed globally and delivered locally.

cgi.com

Paul van der Valk
Director Consulting Services, Payments
paul.vander.valk@cgi.com

Shrenik Shah
Director Consulting Expert, Payments
shrenik.shah@cgi.com

Contact: info.nl@cgi.com

16022024