ARE YOU BANKING ON A HOUSE OF CARDS?

System replacement is a dirty phrase in the payments industry: the risk, the cost, the internal politics and the inconvenience are all huge deterrents. However, in a world that is increasingly embracing alternative payments and modern technological principles, running a business on a platform built for yesterday's payment methods is undeniably illogical. You wouldn't use a Nokia 8110 as a SoftPOS, so why use a card-based platform to run today's payments business?

A changing landscape

For decades, developing a payments offering was relatively straightforward. In the 1990s, payment cards, whether credit or debit, gained traction and increasingly replaced cash as consumers switched to the convenience of card payments. Banks had to create a sufficiently attractive card offering (think Gold, Platinum and Infinite cards), expand their acceptance network and remain vigilant against fraud while growing their brand. Not an easy task – but one that seems comparatively uncomplicated from today's perspective.

In the last 20 years, this comfortable picture has been disrupted. The digital revolution has completely changed the landscape. Major technological breakthroughs in computing and telecommunications have seen consumer access to the internet becoming the norm, while the proliferation of smartphones and the high speeds of communication and data exchange have created opportunities and accelerated this disruption.

Since 2010, these advances have underpinned some of the most significant developments in the payments industry. From e-commerce, contactless payments and biometrics to digital wallets and alternative payment methods - such as account-to-account payments (A2A), buy-now-pay-later (BNPL), and request-to-pay (R2P) - the landscape has evolved to pave the way for non-card based payments.

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In parallel, consumer payment behaviours are in a state of constant change. Today's payment industry is ruled by 'generation now' and digital natives, who often forego the face-to-face banking experiences of previous generations, instead preferring convenience and speed over security and personal interaction.

As such digital-only banks, or neobanks, are one of the success stories of the last decade – not to mention Non-bank Financial Institutions (NBFIs), telecom companies, tech giants and many others crowding the market. Not only are these new competitors not burdened by running on card-based technology stacks of the past, they are running the backbone of their payments business on future-ready platforms that take full advantage of modern technological breakthroughs. This has left traditional banks fighting to retain their market share, struggling to improve margins and dealing with the sky-rocketing costs of maintaining operational norms. Yet despite this extraordinary shift in technology, payments and consumer behaviour, the majority of banks actively decide to remain increasingly burdened by the same inefficient, costly and, at times, no longer fit-for-purpose payments platforms they adopted in the 1990s or even earlier. What is even more astonishing is that not only are banks continuing to operate on these legacy card-based platforms, but when they do decide to modernise, many replace their underlying technology with newer platforms that are still based on cards.

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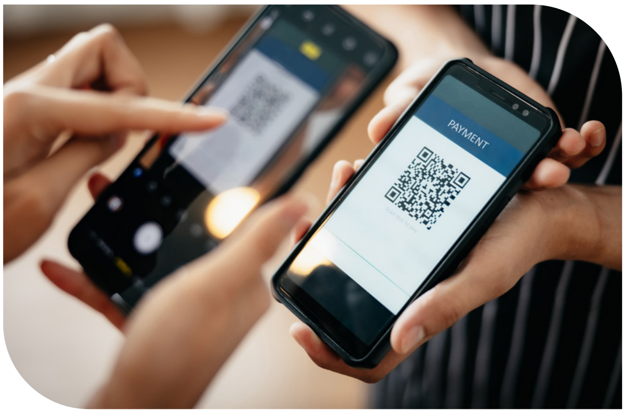

Why card-centric platforms won’t do

All payment platforms developed before the year 2000 have cards at their core, as do all auxiliary systems from that period. However, such architectures are increasingly inadequate as a means of engaging with today’s diverse payments environment. Adopting a card-centric approach won’t work at a time when anyone can be a merchant, every device can be a payments acceptance point and most consumer identifiers can be a payment method, including phone numbers, bank account details and e-mail addresses. A platform focused on cards is unable to adequately represent the objects and functions of a modern payment environment and cannot interact effectively with other systems in a service-oriented architecture, nor function properly in a dynamic cloud environment. Most importantly, these platforms do not enable the rapid development and launch of new non-card based products, because card-based platforms have to take modern payment methods and convert these into “fake cards” to trick the old system into behaving like it was built for today. This adds layers of complexity, multiple points of failure, and confusion, not only for banks and their internal teams, but also for their intermediary partners and customers.

Card tokenisation can seemingly combat most issues; the CX immediately improves because consumers get the payment methods that they want, but at what internal cost? The system only becomes more complex because it’s still card-based. New payment methods don’t sit comfortably on older card-based payment rails that are a world away from the frictionless payments ecosystem the industry is striving for. Fintechs and other disruptors have either developed or invested in

significantly more modern and advanced systems where cards are still supported, but where they are just one of many payment tokens. What's more, their systems are designed in such a way that any token that has not yet been thought of, can be easily added. This is why these industry players are gaining market share, able to target segments often less accessible to banks (unbanked/ underbanked), and will always be future ready, while non-forward-thinking FIs running on legacy platforms built for yesterday's problems will always be playing catch-up at an ever-increasing cost.

Such systems are not just expensive to maintain, they also offer limited vendor independence, meaning banks are trapped in slow-moving development queues unable to manoeuvre with any agility. These outdated payment platforms require continuous extensions, wraparounds, plug-ins and fixes to run in a modern environment, creating a mass of disorganised dependencies, with no clear logic or structure. Non-forward-thinking banks' solution to this issue is to build an orchestration layer to deal with the spaghetti-like architecture of intertwined old and new systems. This in turn escalates maintenance issues to a whole new level of complexity, making everything from system upgrades and extensions to the introduction of new systems arduous, resource and time consuming, and at times impossible.

To banks' detriment, their 'innovative' products are built on or around 'refurbished' platforms, stripping them of their competitive advantage in terms of time-to-market, differentiators and overall price.

Renovating the house of cards

Instead of relentlessly refurbishing underlying payments platforms by adding additional extensions to their house of cards, banks need to realise that their current refurbishment approach has a shelf-life and the end game, inevitably, is complete underlying system replacement. However, choosing the other extreme of demolishing everything and starting from scratch is detrimental, as it gridlocks operational and strategic resources, is extremely time-consuming and expensive, and offers little immediate returns. Therefore, banks need to have a carefully thought-out strategy in order to successfully navigate away from card-based platforms.

A modern future-ready platform underpinning the core payments business is not only important for agile innovation, it also adheres to such principles as cloud deployment, DevOps, and API-first approach, ensuring quick, cost-efficient, streamlined integration, deployment and operations. Last but not least, new technology attracts the most skilled and sought-after developers that are not interested in working on old technology and even less interested in integrating legacy systems together.

It's worth mentioning that, more often than not, FIs who have realised they need to replace their payments backbone, take the leap only to find themselves inadvertently replacing like for like and old for new, which is not the same as investing in a modern, future-proof and non-card based system.

When it comes to high stakes decisions such as these, it is important to undertake a rigorous technology evaluation process, rather than dealing yourself the same hand all over again.

In their *2021 Global Payments Report, McKinsey & Co* noted[1] that successful banks will rethink their payments models and find new paths to value. While remaining optimistic about the overall outlook for payments globally, McKinsey said that they expect a gulf to emerge between those players who make the right strategic choices and others who may be left behind. With this in mind, it has never been more important to move away from the strategies of yesteryear when building, upgrading or replacing the foundations of the architecture on which the business is to run. A house built on cards, is a house built on borrowed time – and with the increasing popularity of non-card based payments, it's never been more important for FIs to take control of their tech stacks rather than continuing with tenuous balancing acts with multiple points of failure.

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1. See *2021 Global Payments Report by McKinsey & Co* at: https://www.mckinsey.com/~/media/mckinsey/industries/financial%20services/our%20insights/the%202021%20mckinsey%20global%20payments%20report/2021-mckinsey-global-payments-report.pdf

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