VIEWPOINT

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2020 Outlook: Commercial and Enterprise Payments

Continuing with digital adoption to deliver better, easier, and faster global services

Technology innovation is leading businesses to expect more information and functionality, delivered across borders in a way that enables easy and safe utilization.

by Steve Murphy,
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Overview

In this Outlook, Mercator Advisory Group's Commercial and Enterprise Payments Advisory Service (CEP) previews the key trends, issues, and success factors affecting the commercial payments industry. This requires insight into the broader technologies, business solutions, and services encompassing commercial payments flows to satisfy trade relationships, which are estimated to be in the range of $130 trillion. There are also myriad other movements of funds, both domestic and across borders for regulatory compliance and to optimize business liquidity. These include central bank reserve requirements, capital markets transactions, loan payments, corporate cash concentration, funding of settlement accounts, and more. The 2020 Outlook generally reflects the upcoming research agenda for this Mercator advisory service, which is on a rolling 18-month schedule. The CEP service provides ongoing insight across the complete transaction cycle where commercial banks' wholesale/corporate businesses and myriad other industry participants provide payments and related services, including treasury, trade, and alternative lending.[i]

The 2019 Outlook Revisited

Before considering the prospects for 2020, we review the outcomes to date for the expectations we expressed in last year's preview of trends for commercial payments in the coming year, the 2019 Outlook, released in November 2018. The review's purpose is to gauge alignment with actual events as they transpired or are transpiring. In the complicated world of commercial banking and payments, it can be difficult to realize transparency in actual technology implementations, but directional progress is generally visible. One invariable theme in the space is risk management, while other priorities have some variation in relation to market conditions, regulations, and technology gains. The themes we anticipated for 2019 and their general results as of this writing (in November 2019) are summarized in the following list:

Linkage in the context of commercial and enterprise payments refers to digital connections in the delivery of cash cycle solutions with subthemes such as the continuing growth of electronic payments, ongoing convergence of procure-to-pay solutions, and a focus on more control of working capital. In our 2019 Outlook, we predicted a relatively steep decline in checks compared to prior measured periods. This decline has started to happen, as evidenced by the most recent Association for Financial Professionals (AFP) electronic payments survey.[ii] We have seen continued movement toward procure-to-pay convergence as well as innovative solutions for better liquidity, particularly in the small-to-medium (SME) business segments.

Harnessing data refers to the expansion of artificial intelligence-related (AI) tools such as machine learning, robotic process automation (RPA), and natural language processing (NLP) for corporate banking use cases. Incorporation of these tools is ongoing in both banking and the fintech space, which we covered throughout the year, including in a research report titled *70+ Processes Banks Have Already Improved Using AI* (see hyperlink to the document in the References section of the present document)

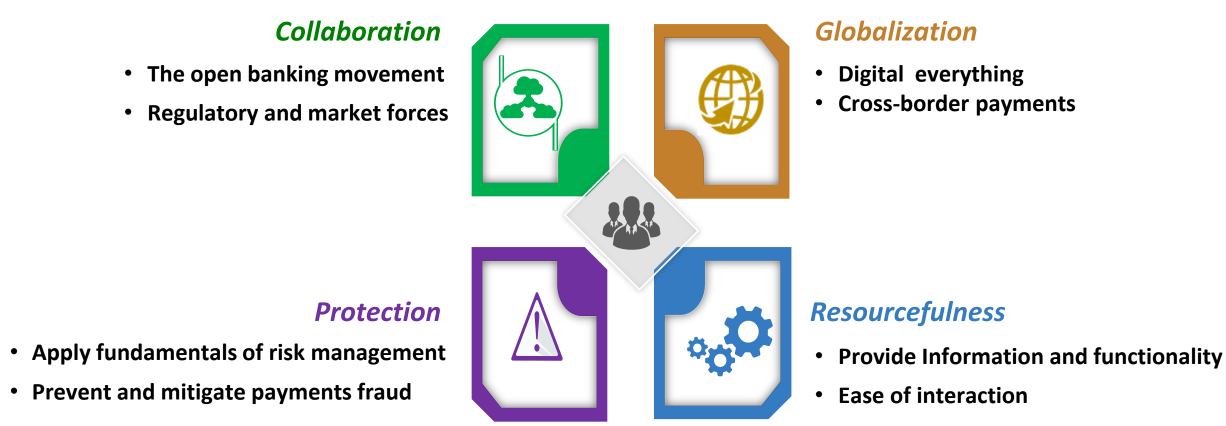
The user experience runs the gamut from easier navigation of bank services to providing faster and better information through the use of application programming interfaces (APIs) as well as a more consumer look and feel to mobile channel interaction. The revised Payments Services Directive (PSD2) in the European Union has motivated large banking institutions in other regions to consider the market impact of business as usual, and therefore fintech collaboration has continued to expand. We anticipate this trend working its way into the smaller asset class institutions in the near future. The mobile experience is clearly in demand and an area where most financial institutions have gotten the message.

Risk management is a staple of the financial services industry. Financial institutions are essentially risk management entities, and therefore this theme inevitably rises to the top of any annual summary of key corporate payments trends. There are still various categories of risk to manage—regulatory, legal, market, operational, and financial—and we have seen no letup in the investments required to keep the fraudsters and other bad actors in check.

Four Themes for 2020 in Commercial and Enterprise Payments

For 2020 Mercator Advisory Group anticipates that commercial payment developments will revolve around the four general themes outlined in ***Figure 1***: ***collaboration*** between financial technology companies (fintechs) and financial institutions to deliver on open banking scenarios, ***globalization*** by reaching broader markets through digital execution and better cross-border solutions, banks demonstrating ***resourcefulness*** by providing easier access to data and solutions, and protection from the omnipresent industry risks. Each of these areas has various subthemes that will define the agenda for Mercator's Commercial and Enterprise Payments Service in 2020.

Figure 1: Themes for success in commercial banking and payments in 2020 and beyond.



Source: Mercator Advisory Group

Moving Toward More Open Banking

Expectations Will Escalate in Europe

Most readers will have some knowledge of the revised Payment Services Directive (PSD2) implementation across the European Union, which was scheduled to take full effect on September 14, 2019, but has been delayed by 15 months to December 2020. The delay is related to Secure Customer Authentication (SCA), PSD2's requirement for dual-factor authentication for online transactions. Another key requirement of PSD2, access to bank account information by Third Party Providers (TPPs), was to take effect in March 2019[iii] and to our knowledge has not been delayed, however. Based on information available, it seems that the vast majority of banks across the E.U. are not in compliance with the PSD2 technical level required for APIs,[iv] which are at the heart of open banking, but strict enforcement does not appear to be underway. Therefore we expect that repercussions of noncompliance and fines may escalate during the next round, leaving 2020 as not only an industry respite but also perhaps an opportunity for successful execution prior to eventual regulatory enforcement. Regardless of the delays, the laws themselves are not changing and the open banking era is upon the industry.

Other Markets Push Ahead

Regulatory compliance-driven efforts outside the European Union and United Kingdom are also taking shape. In July 2018, the Hong Kong Monetary Authority (HKMA) issued an API Framework to contribute to smart banking. Phase II of this project was to have been live as of October 2019, but some delay is expected as a result of the ongoing political unrest and demonstrations in Hong Kong.[v] A Reserve Bank of Australia (RBA) initiative tied to the Consumer Data Right (CDR) law has a phased approach from July 2019 through July 2021, after which all banks are expected to provide access to consumer and product data. Singapore has been very active in promoting an open banking market, although stopping short of compulsory regulations to date.

Besides the regulatory push, market-driven open banking initiatives are underway in various countries, including Canada, India, Japan, New Zealand, South Korea, and the United States. The largest single market is the U.S., where we do not expect any federal mandates in the near future, although the 2018 U.S. Treasury report titled *A Financial System That Creates Financial Opportunities, Non-Bank Financial, Fintech, and Innovation*[vi] clearly endorses greater industry collaboration with governmental support.

Use of APIs by fintechs is already fairly robust, including APIs for payments-related services.[vii] The electronic payments organization Nacha is actively promoting API standardization through a member group named Afinis Interoperability Standards.[viii] Based on Mercator Advisory Group's discussions and other interactions with banks, it appears to us that the U.S. banking industry has a bifurcated approach to cloud and open banking depending on asset size, with the large institutions actively pursuing API usage (in part because of their more multinational client base) while smaller banks remain hesitant. Nonetheless, we see a clear trend in corporate banks adapting to the new age, and we anticipate that collaboration between traditional and new financial services providers will accelerate. The open banking initiatives likely to have the most success in the near term are related to cash management and financing options, where larger financial institutions are already offering easier provision of data and services to corporate treasury operations. Based on our interactions at the Association for Financial Professionals (AFP) annual event in October, financial professionals find this to be a very welcome development. Turning to fully cloud-based alternative banks in the corporate banking sector may be a bridge too far at present, given the deep relationships that corporates have with traditional banks as well as their general concerns around data protection.

Global Trends

E-Payments Rising

One way sovereign markets improve their capabilities to interact on a global scale is by adopting advancements in digital technology, including modern payments systems. An example is India, which now has a gross domestic product of $3 trillion and growth exceeding that of most world economies.[ix] India's recent growth has been spurred in part by government policy initiatives to reduce the country's reliance on cash and paper payments, moving toward high-tech payments systems such as the Unified Payments Interface. A recent report from Capgemini indicates that global noncash payments transactions will increase by 14% during the period from 2017 to 2022.[x] The growth of noncash payments transactions is roughly three times higher developing regions than in mature payments environments, which suggests increased potential for interconnected regional economies.

The trend toward electronic payments in the commercial and enterprise market space is also being accelerated by business-to-business (B2B) e-commerce, which in the U.S. alone exceeded $1 trillion during 2018, an 11% increase over the prior year.[xi] The advent of real-time payments systems will also help further the transition of markets away from paper. In the U.S., where The Clearing House's RTP system has been available since late 2017, another factor is the recently announced plans by the Federal Reserve to develop FedNow, an alternative real-time payments system, which is currently expected to be available by 2024. Mercator believes that this announcement will actually accelerate adoption of RTP, and in a Viewpoint titled *Business-to-Business Faster Payments: Market Review and Forecast 2018–2023*, we predict a roughly 80% annual growth rate in faster payments during that time frame.

Cross-Border Payments

> The idea of cross border payments is going to completely go away . . . our vision is for there to be no distinction between international and domestic payments.
>
> –Jeremy Allaire, Co-founder and CEO, Circle

Mercator Advisory Group believes that the focus on the cross-border corporate payments space is primarily related to the need for easier and more transparent processes to replace the traditional correspondent banking model, which has too many touchpoints and little transaction visibility. Speed is also important depending on the circumstances, but data and certainty are the preference.[xii] The cost of cross-border B2B transactions is perhaps on a sliding scale of importance given their nature and size, with smaller businesses more sensitive to transaction costs. The amount of activity in this space during 2019 reinforces the general industry expectations for solutions that are more globally compelling in terms of scale, connectivity, and speed. Some of these activities include:

- ***Mergers and acquisitions*** between processors, networks, and cross-border systems to gain reach and scale (FIS–Worldpay, Fiserv–First Data, Global Payments–TSYS, Mastercard–Nets, Visa–Earthport).

- ***New cross-border*** payments networks based on or involving blockchain, such as IBM Worldwire and Visa B2B Connect, which can be added to the SWIFT gpi expansion and broader RippleNet access.

- ***Digital currency*** focus by banks (JPM Coin, Wells Fargo Cash), central banks (Sweden, Uruguay, Japan), and tech giants (Facebook). The incremental mainstreaming of cryptocurrencies is also occurring.[xiii] Although free-floating cryptocurrencies (non-fiat) are now too risky for banks to adopt as a B2B payment asset, digital currencies like JPM Coin should meet with reasonable success for two reasons. First, a bank the size of JPMorgan Chase has global reach and an existing network of correspondent and interconnected banks—345 are already reportedly utilizing JPMorgan's Interbank Information Network (IIN).[xiv] Second, JPM Coin is a stablecoin, backed initially by the U.S. dollar, and therefore should meet little resistance from regulators.

- ***Real-time payments*** interoperability between sovereign systems seems inevitable. Several initiatives are already underway, including in ASEAN[xv]and Nordic countries.[xvi]

Provide Expected Resources

Using Data

It is no secret that banks have a lot of data, but it is also axiomatic that they don't necessarily use the information asset as well as they could. As we noted in Mercator's 2019 Outlook on commercial and enterprise payments, the proper use of data in order to optimize the vast technology advancements involves three A's—*analytics, accessibility, and availability*—as was explained in the Euro Banking Association's paper on the subject.[xvii] This is not only a critical factor for financial institutions to capably manage their own businesses but also one of the keys to the hearts of top corporate banking clients in treasury, where data intelligence is rapidly becoming a top priority. A recent survey of several hundred senior corporate treasury executives across Asia-Pacific, Europe, and North America, finds that they believe the three most critical technologies necessary for their corporations to excel in the next five years will be cloud computing (44%), big data analytics (42%), and artificial intelligence (39%).[xviii] The survey also found that cloud was far more important to these treasury executives than it was to survey participants just one year earlier. The financial services industry has been generally hesitant to migrate to cloud processing, so this perspective of treasurers, who are typically conservative due to the nature of their role, is a sign of a shift in attitude. Technology and data were key themes at the recently concluded SIBOS event in London,[xix] so the need for organizations to “get their act together” in pursuit of information excellence should be on the “to do” lists of both banks and corporations.

Functional Convergence

The concept of “banking as a service” has gained some credence in the ongoing open banking discussions. It is essentially a model for delivering banking through apps. We have discussed the convergence of the cash cycle products and services frequently during the past several years, including in a Mercator Advisory Group research report titled *Procure-to-Pay Convergence: Market Review and Vendor Comparison*. The process of digitization allows a bank to connect products internally as well as with external partners, which increasingly is accomplished via APIs. For example, a bank can create a modern payments hub without having to establish a massive, one-off infrastructure project across the institution, as we discussed in 2018 in a Mercator Viewpoint titled *Payments Hubs: Renaissance*. Such ease of navigation also provides a better user experience for clients by letting them consume products through a single interface via their preferred channel, which increasingly is the mobile channel. A separate treasury survey found that 70% of corporate treasurers across Europe, the Middle East, and Africa believe that a shift from services provided by banks to services provided by nonbanks will take place within their organizations over the next two to five years,[xx] which is a fairly clear signal for new approaches to service delivery.

> Two decades after the Internet became a platform for transformation, we’re still wondering how it all might turn out. The signals aren’t always clear. Today, winner-take-all organizations are on the rise, but collaborative ecosystems are flourishing as well. Even in industries where competitive concentration is increasing, innovation hasn’t – as would be expected – flatlined.
>
> The organizations that are prospering aren’t lying in wait to time the next inflection point – the moment when a new technology, business model or means of production really takes off. Remaking the enterprise, they recognize, isn’t a matter of timing but of continuity. What’s required, now more than ever, is the fortitude for perpetual reinvention. It’s a matter of seeking and championing change even when the status quo happens to be working quite well.
>
> –*Global C-suite Study*, 19th edition, IBM Institute for Business Value[xxi]

Protection

Bank Fundamentals

As we pointed out in a Mercator research report titled *Fighting Payments Fraud: No Rest for the Weary*, financial institutions across the globe generally remain one of the industry segments most trusted by corporate clientele. That trust is not only an asset that prevents client churn but an essential requirement for the most closely regulated global industry. Banks must manage a number of categorical risks, summarized in the following list:

- ***Credit risk*** results from the clients' nonpayment of debt owed to the bank, loans being primary bank assets.
- ***Liquidity risk*** can affect a bank's ability to meet its payment or clearing obligations.
- ***Market risk*** results from adverse movement in market rates or prices.
- ***Operational risk*** is the possibility of financial loss resulting from inadequate or failed internal processes, people, and systems and external events. The impact of various forms of cyberattack and payments fraud losses falls here.
- ***Reputation risk*** is negative publicity resulting from any number of factors, while ***legal risk*** comes from adverse judgments, lawsuits, or bad contracts.

All of these risks can lead to capital or solvency issues as well as regulatory pressure or negative actions such as fines or limits on allowable bank activities. As we pointed out in the Mercator research report titled *Dodd-Frank and Corporate Banking: Still Murky After All These Years*, banks have made many risk-based investments since the Dodd-Frank Act of 2010, some of which were short term to manage stress tests but most of which represented incremental ongoing compliance expenses, which is one reason for the rise of regulatory technology ("regtech").

Prevention and Mitigation

Since payments fraud is an operational risk and a key focus in corporate banking relationships, we identify two overall lines of defense that financial institutions (and corporations in general) need to have in place and consistently review for adequacy: **enterprise threat protection** and **specific payments protection systems**.

The pathway to success for fraudsters is to gain personally identifiable information and/or personal financial information. Preventing breaches and monitoring ongoing operational activity, including payments, is where investments continue to be made. The latest generation of technologies being used for this purpose include artificial intelligence (machine learning) for better prevention and faster identification, blockchain (controlled access), tokenization (masking account information), and biometrics for authentication. Solutions are available across the spectrum of fraud vulnerabilities. Financial institutions understand the potential aftershocks and therefore have traditionally done a very good job of managing this operational risk category.

> To ensure the integrity of our financial system, protect our vulnerable people and communities, and attract business to the UK, we must do all in our power to combat economic crime. Last year the Financial Action Task Force found that the UK had one of the toughest systems for combating money laundering and terrorist financing in over 60 countries it has assessed to date. Criminals, however, are continuously adapting their methods and we know there is more work to be done.[xxii]
>
> –HM Treasury and Home Office, United Kingdom, *Economic Crime Plan, 2019–2022*

Conclusions

In the corporate banking and payments world, barring some sort of crisis, there are typically few major swings in priorities from year to year. As such, moving into 2020 Mercator Advisory Group sees a general continuation of the overriding themes from 2019. A global movement toward open banking is basically inevitable, since technology capabilities, government dictates, and market forces are combining to drive wider adoption. Collaboration between fintechs and the traditional providers of financial services will continue as these market participants see opportunities to learn from each other and better capitalize on opportunities. The continuing rise of digital processes and innovation in the business-to-business payments space has led to new cross-border expectations by businesses, which we expect to be more prominent next year as the new networks gather scale. The convergence of cash cycle products and services will continue, creating ease of use and end-to-end process coverage. Data intelligence is an ongoing focus, and corporate treasury operations are seeking improved analytics delivered through the cloud. Banks must continue striving for more seamless delivery of transaction banking services as clients' preference for mobile channels increases. Risk management is a fundamental requirement of the banking industry and a critical investment priority every year. Banks function as the liquidity engine for global economic activity and will always be a prime target of bad actors who wish to move and capture funds illegally. With the next decade just around the corner, financial institutions and other industry service providers will have continue adapting to this brave new world marked by unprecedented speed of change.

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Trends in Global Regulations: Corporate Banking and Payments (June 2019)

Commercial Payments Mid-Year Review: Glancing Back and Peeking Ahead (June 2019)

70+ Processes Banks Have Already Improved Using AI (January 2019)

Fighting Payments Fraud: No Rest for the Weary (December 2018)

2019 Outlook: Commercial and Enterprise Payments (November 2018)

Procure-to-Pay Convergence: Market Review and Vendor Comparison (September 2018)

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Dodd-Frank and Corporate Banking: Still Murky After All These Years (January 2018)

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