



# Payments outsourcing

Pros, cons and considerations that should be on your radar



## Payments outsourcing

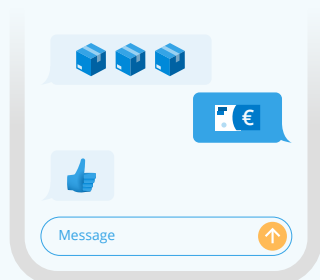
Payments has been undergoing a perfect storm, with the introduction of Instant Payments in Europe and the launch of Open Banking/PSD2. On the infrastructure side, SWIFT has introduced gpi, setting the new standard for cross-border payments. EBA CLEARING kick started its Request to Pay project, which is set to launch in 2020.

The European Central Bank launched TIPS (TARGET Instant Payments Settlement) in November 2018, with a very aggressive pricing strategy. All this has forced banks to have a close look at their future strategy when it comes to payments processing. Accenture [found](#) that “many banks and payment service providers are contemplating or have already begun overhauling their payments infrastructure.” As we briefly discussed in part I of our series, banks are considering outsourcing payments to rise up to this challenge.

Outsourcing allows them to focus on their key differentiators and providing outstanding service to customers, at a time when they are facing increased regulation and competition from tech companies. In this second installment of our series, we explore the pros and cons of payments outsourcing and provide guidelines for banking institutions to consider when choosing a vendor. Let's first take a look at the industry landscape.

## The promise of Instant Payments

Undeniably, Instant Payments holds a lot of promise. It means finally moving away from 9-to-5 batch based, fire-and-forget processing to 24/7, real-time processing with track and trace capabilities. Think of this as a type of "WhatsApp" experience, where the delivery of a payment gets confirmed to the sender. For businesses and governments, the ability to connect goods and services to real-time payments anywhere and at any time is hugely transformative, as it reduces friction in supply chains and global trade. But this poses challenges for banks, who are struggling to keep up with increasing requirements while trying to lower costs. How are they adapting?



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## The market is consolidating

If we take the European market, there are roughly 6,250 banks processing around 84 billion transactions annually ([source: EBF](#)). The top 30 banks process over 65 billion transactions, while the remaining transactions are processed by the rest. To put this in perspective, 80% of the total payments volume is processed by 0.4% of the banks. The numbers speak for themselves. The market is consolidating. A 2018 European Banking Federation report shows that the total number of credit institutions in the EU have gone down by 31% since 2008. Governments are also urging consolidation. In April this year, France's Finance Minister, Bruno Le Maire, said that the European banking sector was "too fragmented" during the Eurogroup Summit. His views were echoed by François Villeroy de Galhau, who sits on the Board of Governors of the European Central Bank. The main argument for consolidation is systemic resilience. The other argument is cost efficiency.

Consolidating may help in reducing costs. If payments processing platforms are merged and standardized, older platforms can be discarded and the efficiency gains can be momentous. The premise is that when the costs of developing and maintaining the platform can be divided over a larger number of transactions across that same platform, the cost per transaction goes down.

Unfortunately, the reality is not so clear cut. Consolidating two distinct payments platforms with their own business rules and their own history is a major undertaking. For example, ABN AMRO budgeted [around 1.5 billion](#) of exceptional costs for integrating Fortis Bank Nederland.

The merger was a success. Fortis Bank was integrated into ABN AMRO on time and within budget, but it did force the bank to redirect its resources and shift its focus away from the market and towards internal processes and integration.



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## The upside: outsourcing reduces costs, frees up internal capacity and speeds up implementation

An alternative to creating scale through M&A is creating scale by outsourcing payments. Partnering in this transformation offers the bank major advantages. Outsourcing frees up internal capacity. It also allows banks to focus on their differentiating activities. The need for continued compliance in “non-differentiating” capabilities like payments processing is also externalized, liberating resources. Another benefit is the ability to capitalize on external talent and industry best practices. Typically, an outsourcing partner has vast experience in implementing a new payments platform. This helps the bank reduce risk and speeds up implementation.

In sum, when properly done, transferring the payments processing functions – or part of them – to a third party minimizes complexity, costs and risk. What of the limitations of outsourcing?

## The downside: less flexibility

For all its benefits, outsourcing often comes with an important trade-off. In exchange for an efficiently managed service, the service is typically shared and therefore standardized across multiple clients. This limits the ability of a bank to offer tailored services to customers. It can also be difficult to efficiently integrate the outsourced service into the bank's existing application landscape. The service provider often dictates the payments process flow. Sometimes, it dictates the interfaces to be used by the bank and even business rules, in extreme cases. Although the old adage: "a payment is a payment is a payment" is still valid, standardization to this degree does increase the bank's integration effort and hampers its ability to compete.

Therefore, it is crucial to evaluate the flexibility of the offered service, and perform due diligence to determine how flexibility can be achieved in combination with scale. Most core payment engines in the market today are extremely good at processing high volumes of payments in a secure and compliant way, but are designed to be implemented for a specific bank with its specific rules and requirements. When these engines are used in a multi-bank setup, as they are in outsourced payments, they either support multi-instance or multiple participants on a single instance, but rarely offer a true multi-bank setup. In a multi-instance setup, the bank effectively gets its own dedicated setup, with

the accompanying running costs. This greatly diminishes the benefits of outsourcing. In the multi-participant setup, the platform shares business rules across all participants, limiting differentiation in the market. So what should you consider when choosing a vendor to partner with?

## A consideration set for outsourcing partners

When it comes to architecture, banks should consider the following criteria when evaluating vendors:

- **Reusable business services:** functionality within a payments platform needs to be broken down into small business services, which are reusable across different payment products and payment flows. An IBAN validation, for instance, should be designed as a single function, which is reused where it is needed. When the IBAN validation needs to be updated as a result of a rulebook update, this only needs to be done once. This ensures not only predictability, but also minimizes the resources needed for maintenance and testing.
- **A distinct connectivity layer and message transformation/mapping:** in order to integrate the payments platform into the bank's environment seamlessly, the platform needs to be able to easily support new message formats and new message protocols, without impacting core processing. A clear separation between application logic and message transformation, combined with standardized central data storage, is key.



When a payments processing service is designed with these two criteria in mind, it is easier to define the payments processing flow at a bank level, while reusing standardized business services. For example, in a scenario where a balance check is needed to determine if a customer has sufficient funds for a transfer, Bank A may choose to send the payment for manual approval, while Bank 2 may choose to simply reject the payment – all the while, keeping the balance check itself as a standardized business service. Another example would be the ability to perform an AML (Anti Money Laundering) check for Bank A when the payment is received, while performing the check for Bank B right before the payment is sent to the clearing house.

The second big advantage is the ability to implement specific interfaces and messages without impacting the core data model or business logic, through a distinct message transformation layer. This greatly alleviates the implementation effort for the bank, and allows for easy migration of bank-specific components in the future.

Note that these design criteria are not theoretical architecture principles, but are already part of leading payments platforms. Besides these, it is vital that the insourcing party has the capability in place – both from a technology as well as from a process perspective – to integrate new customers and support their specific requirements, while realizing and maintaining economies of scale.



The new platform needs to support 24/7, real-time payments processing, with a redundant setup of the underlying infrastructure (i.e. an active-active setup across two data centers) and operational processes that work around the clock. This comes on top of continued compliance to new rulebooks and regulation.

More generally, a recent [KPMG publication](#) also offers insights for banking institutions considering the benefits of partnering with fintech players. **The following stand out as relevant for outsourcing considerations:**

- Customized and personalized products and services, using advanced data analytics to curate products that are more relevant to each individual customer
- A focus on platforms and ecosystems, engaging with a networked ecosystem of customer-focused value propositions
- Focusing on collaboration as much as on competition, offering incumbents an opportunity to develop an ecosystem of partnerships
- Technological agility, using a modular, micro-services architecture that enables them to use data to drive actionable customer insight



## Summing up

Collaboration between financial and non-financial organizations is key to keep up with the fast pace of change in the ecosystem. Outsourcing vendors recognize the advantage of having financial industry partners that understand the regulatory framework, have long standing customer relationships and large volumes of customer data. While traditional banks are increasingly looking at these types of partnerships as a cost-effective and accelerated method to bring new capabilities and experiences to market. It's key for banking incumbents to evaluate potential partners' flexibility and scalability.

At my own company, Visma Connect, we are implementing a new payments platform which is designed according to the latest requirements: real-time at its core, with a clear split between interfacing and application logic and built up from business services. Contact us and find out how you can outsource the hassle and insource agility.

## Would you like to know more?

For further information, go to [www.vismaconnect.nl](http://www.vismaconnect.nl)  
or call +31 (0)88 - 11 61 800.

 [Click here for more information](#)

## About Visma Connect

Visma Connect offers: payment services, information portals and integration services. Our experts are specialized in Payments, Standard Business Reporting, Blockchain and Artificial Intelligence. Visma Connect was established in 2006 as EBPI and since 2019 has been part of the Visma Group.

## About Visma

Visma delivers software that simplifies and digitises core business processes in the private and public sector. With presence across the entire Nordic region along with Benelux, Central and Eastern Europe, we are one of Europe's leading software companies.

We believe in empowering people through technology. By helping close to one million customers run their business every day, we give companies a competitive edge and individuals time to focus on what they love.

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