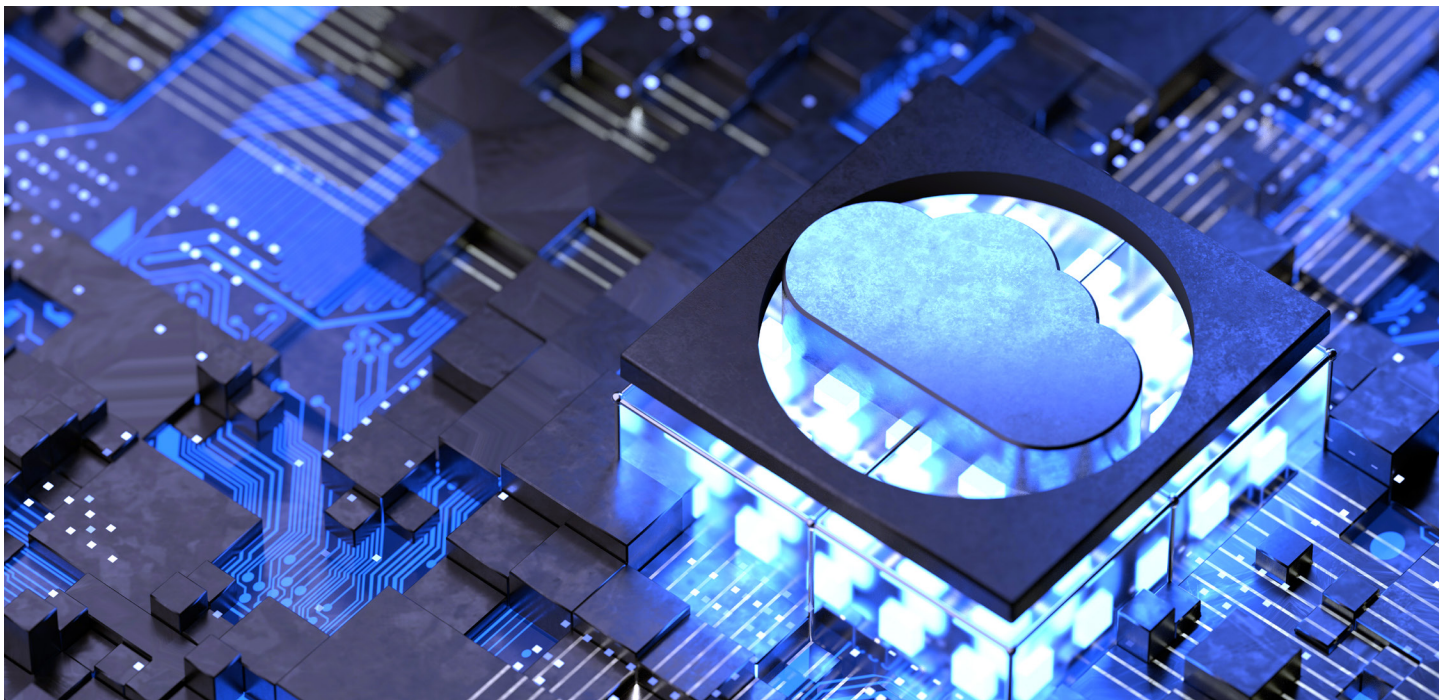


Payments Modernization: What Does It Really Mean?



The payments ecosystem in the United States is very much in flux, with en masse adoption of faster and real-time payments. Scalable, real-time payments technology is essential for banks and credit unions to compete with challenger banks and neobanks. However, how can financial institutions overcome the constraints of inflexible legacy platforms?

In a [webinar](#) hosted by The Financial Brand, Jim Marous, Co-Publisher, at The Financial Brand, and Al Griffin, Principal Solutions Consultant at Alacriti, tackled current challenges with payments modernization and orchestration, why some financial institutions are struggling to compete with challenger banks and neobanks, and how they can better position themselves to compete.

Changing Expectations

In banking, ways to engage with consumers are always an important topic. Payments have a tremendous amount of activity in the banking world, and there are many possibilities when it comes to reacting to consumer data and building contextual solutions around payments behavior. Marous lamented that the traditional banking industry really gave away the payments and merchant business due to a lack of reaction to trends in the business. "As a result, large tech companies and fintechs have really dominated a lot of modernization of payments. Now more than ever,

financial institutions of all sizes have to think about how they can be future-ready and build a platform for the future of payments. It's not just the payments. It's the flow of funds," Marous shared.

Expectations have changed. Consumers are no longer willing to accept a wait for certain transactions to happen while others happen immediately. For consistency to happen, top management at financial institutions has to commit to effect change. Marous asserted that there is no such thing as an organization being too big or too small to modernize. "I visited a number of organizations, and it's amazing how an organization under \$1b can already be at the front end of the curve in not only payments modernization but also instant payments.

The pandemic sped up the modernization needs and requirements of financial institutions, especially since the 2017 launch of The Clearing House's RTP® network, which started a trajectory of change. Griffin estimated that the evolution of faster payments happened 12–18 months faster than we would have seen if not for the pandemic. Griffin shared his observation. "Payments is becoming a driving force, even more so within the financial institution. It can put them on a level playing field with other financial institutions, regardless of their size, in terms of how they can meet their account holder specific use cases around the real-time payment persona."

Necessary Elements for Modernization

Payment modernization today means a 24/7/365 operation model, something financial institutions have not done before. Now, being able to take a payment, process it, and post it on a Saturday night or a holiday when traditionally posting wouldn't happen until the next day or the next business day is a big change. Financial institutions have to think about what it means in terms of impact on their comprehensive set of infrastructure.

Questions to Consider in Preparation for Real-Time Payments:

- Is the core system capable of real time?
- What ancillary applications are going to be touching real-time payments, and are they ready, or will work need to be done?
- Does everything have to be ripped out, or can real-time payments work in conjunction with existing systems?
- Is the product viable for both today and the future strategy for consumers, corporate structure, and small business structure?
- What are the B2B needs for both corporate and small business payments?

Benefits of Modernization

Businesses need to be able to provide the invoices they're looking to send or receive for payment and have them seamlessly go back to their account reconciliation system without having to manually key in payments. They benefit from not having to worry about an ACH payment clearing two days later or a credit card payment clearing

later and then someone deciding to cancel their payment. The beauty of real-time payments is that they're all final, non-revocable, and the money is transferred within seconds.

Financial institutions shouldn't be afraid to monetize something that is an invaluable tool. Consider that wires are monetized today. So a financial institution is not necessarily expected to give away the ability to do a payment faster when they're already charging a fee for wires. At some institutions, moving money from an account at one financial institution to another can be a 1–3 day wait for those funds to settle. However, it can be instantaneous through real-time payment rails. That's a value consumers are willing to pay for, as evidenced by Venmo charging for instant transfers.

The omnichannel experience, which is a concept that's been a priority for a long time, is about meeting the customer or member [where they want to be met](#). For example, if they do everything on their phone, that means they need a solution where they can use their phone to open a loan, fund an account through a phone check deposit, ask [Amazon Alexa](#) to make a payment, or make a principal payment through online chat. Part of a modern experience is to really have seamless integration across all channels.

Payments Orchestration

Payments orchestration provides that seamless integration. Alacriti's [Cosmos Payments](#) platform has open APIs and microservices that can connect with a financial institution's online banking platform and provide a digital overlay for a specific use case. For example, if a bank needed to consume a batch file of payments but needed them dispersed in multiple ways, payments orchestration could help with that.

It used to be that accountholders would know what route they were going to take specifically, ACH or wire. However, payments orchestration doesn't require the end-user to know what the rails are. All that's needed is the timeframe that they're expecting. Orchestration enables the routing of payments through rules the financial institution has defined within the platform or specific instruction from the originator (e.g., this needs to be a wire). This allows for least-cost routing (a.k.a smart routing or intelligent routing). This is very similar to FedEx, where the package is sent via a route depending on when the package needs to arrive. And just like FedEx, where the package can be tracked, orchestration allows the payment to be tracked. There are also ancillary pieces, such as fraud detection, AML detection, funds and [account validation](#), etc.

Enterprise Providers vs. Third Party Providers

Marous asked a key question, "Let's say I'm a financial institution that works with a core provider that basically offers payment solutions. Why would I look to a firm like Alacriti to handle my payments?" Griffin started his response with two key words, 'speed' and 'agility'. "A core provider may not necessarily move at a pace that a Fintech like Alacriti can move. We're much more agile to provide the service work in conjunction with what you already have. Let's say your core is providing you with the

ability to receive real-time payments today, but it's going to be another 9–12 months before you're able to send real-time payments or Request for Pay. We can facilitate that and work in conjunction with services that you already have vs. having to wait for the core provider to provide that functionality. We can get a financial institution up in 8–10 weeks for receive-only. And then another 8–10 weeks to add the send persona. I've heard from other providers that sometimes 9 or 12 months. We have a track record with The Clearing House that proves it. So we can certainly have you up and going in an operational mode quickly, probably faster than anyone else in the industry in that aspect."

It's key to not wait until the account holder goes to the competition for real-time payment capabilities, because what is the probability that they will return when their original financial institution implements a modern solution? Also, it's important to keep pace with innovation, which means innovation on a monthly basis vs. an annual or semi-annual basis.

Working with a third-party provider doesn't necessarily mean sacrificing integration. Alacriti works with many core system providers and online banking systems, making it possible to take organizations at any level of digital transformation and work with them to make their payments modernized. Financial institutions should look for platforms that are in an [ISO 20022](#) native format and open API and microservices-based architecture.

This makes it possible to connect to any type of other third-party application to get payment information, and then posting can be done right back to the core system. This is especially important considering how many payment channels there are with their own set of respective databases and permission sets e.g. mobile, loan, or account opening. These silos create a need to make the user experience consistent across the board and to provide reporting across all the different channels to get a clear picture of what the account holder is doing, providing an opportunity for upselling or identifying what's not being used.

Moving Forward

To get real-time payments, financial institutions don't need to have all the capabilities at once. Some are in receive-only mode right now and thinking about whether or not to move to origination. Receive-only is a lot easier because the financial institution has to have their core able to take the payments as they come in and post them in real-time. It's all credits coming in, so there is no FedNowSM Service or TCH RTP network account to be managed. Eventually, all financial institutions will have to do send and receive. However, moving into origination can be a bit more complex. Financial institutions have to decide how they're going to originate real-time payments through the various channels (online, mobile, etc.). The Request for Payment ([RfP](#)) capability is also anticipated to explode in popularity, as it helps businesses with their liquidity, and it also gives the financial institution the potential to get additional deposits that formerly went elsewhere because customers were finding other ways to get money instantly.

There are many things needed to integrate the bank's core fraud and other systems. The Alacriti platform supports that, working with the core directly. In addition, fraud tools will be inherent within the application. There will also be a capability to tie in other enterprise fraud services that the financial institution is utilizing. This is yet another element that makes a microservices, API-based platform valuable.

Real-time payments aren't beyond the scope of a small financial institution. It can help them compete with the larger players. Also, they wouldn't have to necessarily be the owner of everything. Alacriti could manage the back office funding capabilities through a funding agent, making it possible for the institution to effectively utilize the real-time payments rail.

Some institutions may be waiting for the FedNow Service to go live. However, the FedNow Service and TCH RTP network are not interoperable. So that means real-time payments must go from one FedNow bank to another or one RTP network bank to another. It's not possible to send a real-time payment on an RTP network rail and have it arrive on a FedNow rail. That hinders ubiquity. So if the likelihood is for a financial institution to do both rails, it's a good idea to start on the RTP network, which is available now, to ensure that operations are set up for real-time payments.

What is the Benefit of Real-Time Payments

The value of real-time payments is that the money is instant (24/7/365), and the money is non-revocable. There are numerous use cases for this across the board. For example:

- A customer whose power gets cut off and can't get it back on because they can't get the bill paid instantly.
- A person who wants to purchase a car and needs to get funds to the dealership instantly instead of having to wait for the end of a holiday weekend
- A merchant who keeps running into difficulties from customers making legitimate purchases and then contesting them as fraudulent.

The ISO 20022 format is also important from a global perspective so that real-time payments can be done not only domestically but through a global exchange as well.

Many challenger banks have positioned themselves as being able to clear paychecks faster, process payments the most efficiently, and all on an overarching engagement platform that integrates with everything the account holder does. Chime is a good example of this. Consumers are increasingly moving to challenger banks and neobanks. It is estimated that by 2024, there will be [47.5 million](#) digital-only bank account holders in the U.S. To compete, financial institutions need to continually innovate and modernize their platform across all different elements, including payments.

One of the reasons why challenger banks and neobanks are so successful is that they're new. Everything they're using from a technology standpoint is new, API enabled, operating from the cloud, etc. Operating from the cloud allows them to focus on delivering to the consumer rather than managing hardware and software

sitting on-site and making sure everything is updated. Many traditional financial institutions are faced with the challenge of turning a batched-based operation that's been operating for 40–60 years into a real-time, second hosting application.

In conclusion, Marous offered his advice. "I implore upon every one of the financial institutions on the call today to realize that you've got to be able to embrace change, take modified risk, and disrupt your organization in a way that doesn't look the same as it did before. You can't continue to be a legacy financial institution and hope to jump into the future unless you're willing to listen to organizations like Alacriti to be able to implement the innovation that's possible at speed. The biggest part of digital transformation is being future-ready. It's not just moving to the point where we are today, but position your organization in a way that you'll be ready."

To learn more about what payments modernization means today, watch the full webinar, **Payments Modernization: What Does it Really Mean**, featuring The Financial Brand and Alacriti.

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Alacriti's centralized payment platform, *Cosmos Payments*, provides innovation opportunities and the ability to make smart routing decisions at the financial institution to meet their individual needs. Financial institutions can unify payment processing all in one cloud-based platform—ACH, the FedWire Funds Service, TCH RTP® network, Visa Direct and soon, the FedNowSM Service. To speak with an Alacriti payments expert, please [contact us at \(908\) 791-2916](tel:(908)791-2916) or info@alacriti.com

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