Q2

Top 10 Trends in Wholesale Banking and Payments, 2020: Modernizing and Future-Proofing

Wholesale Banking & Payments

January 2020

© 2020 Q2 Holdings Inc. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

Aite PARTNER. ADVISOR. CATALYST.

Top 10 Trends in Wholesale Banking and Payments, 2020: Modernizing and Future-Proofing

JANUARY 2020

Wholesale Banking & Payments

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited. Photocopying or electronic distribution of this document or any of its contents without prior written consent of the publisher violates U.S. copyright law, and is punishable by statutory damages of up to US$150,000 per infringement, plus attorneys' fees (17 USC 504 et seq.). Without advance permission, illegal copying includes regular photocopying, faxing, excerpting, forwarding electronically, and sharing of online access.

TABLE OF CONTENTS

TOP 10 TRENDS FOR 2020 ... 3
USABILITY TRUMPS FUNCTIONALITY ... 4
CASH AND LIQUIDITY PRODUCTS MOVE DOWN-MARKET ... 5
REAL-TIME PAYMENT STRATEGIES SHIFT FROM “IF” TO “WHEN” AS NEW USE CASES EMERGE ... 6
PAYMENT AUTOMATION BECOMES A GREATER FOCUS ... 7
OPEN BANKING GETS MONETIZED AS API STRATEGIES ADVANCE ... 8
AI BECOMES A REALITY BEYOND FRAUD PREVENTION ... 9
PREPARATION BEGINS FOR POSSIBLE RECESSION AND NEW MARKET DYNAMICS ... 10
CLOUD ADOPTION CONTINUES ... 12
NEW OPPORTUNITIES FOR BANKS AND TECHNOLOGY VENDORS EMERGE ... 13
DIGITALIZATION BECOMES BOTH EXTERNAL AND INTERNAL ... 14
CONCLUSION ... 16
RELATED AITE GROUP RESEARCH ... 18
ABOUT AITE GROUP ... 19
AUTHOR INFORMATION ... 19
CONTACT ... 19

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.

TOP 10 TRENDS FOR 2020

The global wholesale banking and payments industry is evolving at an unprecedented pace with technological advances and a more demanding customer base as its primary drivers. Expectations from corporate users for greater automation, easier access to consolidated information, and data-driven advice and engagement are forcing financial institutions of all sizes to take a step back to evaluate current processes, product portfolios, and end-user experiences. Technical architectures must be modern, open, and flexible to enable API strategies and easier integration with third-party applications to not only meet today's market expectations but also future-proof for what's to come. Development methodologies must be agile to incorporate regular client feedback for enhancement, as institutions also look to improve usability of complex products as they begin offering them further down-market.

Fortunately, new technology is available to support FIs and fintech companies as new strategies and needs emerge. In fact, FIs are quickly realizing that they can no longer go it alone as they increasingly find themselves partnering with leading technology providers for greater innovation and speed to market. Those technologies are not only enabling an experience that is more closely aligned with customer expectations but also helping bank back offices to enjoy greater automation, efficiency, and cost savings. Banks understand that true digital transformation will not take place if they only focus on the client-facing front-end systems and ignore dated legacy technologies on the back end. Thus, front-to-back technology replacements are needed to accommodate today's challenging times, which require new levels of nimbleness, speed, and change management from FIs.

As we get ready to enter the next decade, Aite Group has identified 10 trends that will shape wholesale banking and payments around the globe in 2020 and beyond:

- Usability trumps functionality.
- Cash and liquidity products move down-market.
- Real-time payments shift from "if" to "when" as new use cases emerge.
- Payment automation becomes a greater focus.
- Open banking gets monetized as bank API strategies advance.
- Artificial intelligence (AI) becomes a reality beyond fraud prevention.
- Preparation begins for a possible recession and new market dynamics.
- Cloud adoption continues.
- New opportunities for banks and technology vendors emerge.
- Digitalization becomes both internal and external.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

USABILITY TRUMPS FUNCTIONALITY

By Christine Barry

Corporate banks have long focused on meeting the complex functionality needs of their largest customers, with little attention to user experience for which end users have historically had low expectations. However, the tides have turned as technology has become a greater part of our personal lives, and exposure to the superior customer experiences offered by fintech companies and online retailers has altered expectations for all aspects of banking, from consumer to corporate. Functionality-rich yet usability-poor offerings commonly found in the corporate banking world are no longer acceptable. Thus, a bank's failure to enhance usability through digital transformation initiatives will significantly impact its ability to attract and retain customers in 2020. In fact, most end users, regardless of company size, now consider usability to be even more important than functionality. Among smaller businesses generating less than US$20 million in annual revenue, 56% consider the usability of a bank's online offerings to be "very important" compared to only 40% feeling that way about robust online functionality when selecting a new bank partner.[1] As bank offerings are commonly viewed by businesses and corporate customers as capable of meeting their core functionality needs, it is through user experience that banks have the greatest opportunity for differentiation.

Over the coming months, banks will continue to move forward with digital transformation strategies put in place over the last few years with user experience enhancements, such as greater onboarding automation, more frictionless interactions and transaction setups, and easier access to desired information, at their core. They will also progress to include an increased focus on how data is delivered and more streamlined access to bank systems, including new access points such as smartwatches and facial recognition for authentication. APIs will be increasingly leveraged by all sizes of banks to not only more seamlessly deliver information to other third-party solutions leveraged by customers but also deliver a richer, more consolidated account view within the bank portal.

Finally, during 2020, banks and their technology partners will make significant progress toward better leveraging data, analytics, and machine learning (ML), all of which are critical to achieving banks' desired shift toward more intelligent engagement strategies to deliver better alignment between system workflows and customer/bank interactions. By better utilizing analytics to create richer data out of information that once sat idle within their systems, banks will demonstrate an improved ability to offer advice, cross-sell products, and position themselves as partners rather than simply transaction providers. New tools and enriched data will enable banks to help customers overcome critical challenges, such as more effectively managing their finances, more efficiently running their operations, and better predicting and forecasting future cashflows. Offering an improved user experience will be mission critical for banks serving all sizes of business customers during 2020. Doing so will also better position them to compete with challenger banks currently targeting primarily consumers, but that inevitably will focus greater attention on commercial customer niches, especially within the small-business customer segment, over the coming months.

1. See Aite Group's report *Understanding the True Needs of the Critical Small-Business Segment*, September 2019.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

CASH AND LIQUIDITY PRODUCTS MOVE DOWN-MARKET

By Christine Barry and David O'Connell

A greater overall comfort level with technology, merger and acquisition activities, and online marketplaces resulting in a larger share of business being conducted overseas, has resulted in a greater demand for cash management and liquidity products by all sizes of businesses. Small businesses, with the exception of some microbusinesses, have grown in sophistication. While their transaction volume is significantly lower than that of their larger corporate counterparts, many of their needs from a functionality standpoint are growing more similar. These businesses require money management and forecasting tools, entitlement capabilities, fraud protection products such as positive pay, receivables automation, and more payment options beyond basic online bill pay for both domestic and international payments. During 2020, banks will make more of these products available to this customer segment to deepen relationships with them and better address their growing needs.

A similar trend is also being seen among middle-market businesses. As a result, many banks, especially the regional players for which middle-market customers are often a sweet spot, are increasingly enhancing the usability of many of their cash and liquidity products to better accommodate the new needs of these customers. For example, these banks are seeing high levels of demand from these customers for products such as multicurrency accounts and integrated receivables that have historically been targeted mostly at larger companies. Next-generation forecasting capabilities, with embedded analytics and ML, have also been highlighted by many banks as representing a huge opportunity to not only help middle-market customers overcome a huge challenge but also deepen client relationships and grow deposits. Unlike large corporations that are more likely to have treasury management systems and go directly to technology providers to help them with their integrated receivables and payables needs, middle-market businesses are often more reliant on their bank portals for such capabilities. A lack of critical functionality and tools in these areas has forced many of these businesses to resort to manual processes, which are both inefficient and prone to error.

During 2020, both small businesses and middle-market customers alike will enjoy new tools and scaled-down versions of products once offered only to larger businesses from their banks. Those banks adopting such a strategy and offering those products will enjoy richer client relationships, new revenue opportunities, and deposit growth. However, true success with these customers will also require banks to knock down the silos that commonly exist between the credit and deposit sides of the bank. However, achieving better collaboration will require banks to make process change a priority. After all, Aite Group found that among examined lenders surveyed on this topic, 40% or more found processes for underwriting, approvals, and renewals to be at least somewhat challenging when servicing treasury-management-only customers. But this is a must as businesses tend to borrow where they deposit and vice versa.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

REAL-TIME PAYMENT STRATEGIES SHIFT FROM "IF" TO "WHEN" AS NEW USE CASES EMERGE

By Erika Baumann and David Bannister

Adoption of real-time payment capabilities is rolling out across the globe. While some countries have been live for decades, North America is still catching up. In the U.S. specifically, the first account-to-account real-time scheme for business payments went live in November 2017. The number of banks live on the network and offering real-time payment capabilities to their business clients seemed to be holding steady at about 15 banks for most of 2019. However, even with the seemingly low number of banks offering RTP, the penetration into U.S. demand deposit accounts (DDAs) hit over 50% penetration. In 2020, more banks will go live. While RTP has been called a large-bank solution, the most notable entrants into the RTP landscape during 2020 will be credit unions and community banks enabled through funding agents that are committed to bringing real-time capabilities to clients of these smaller institutions. Additionally, core system providers will make headlines as they provide banks the ability to connect to the RTP system.

Also in 2020, we will continue to learn about FedNow, the real-time gross settlement system that the Federal Reserve plans to launch sometime around 2024. While the Fed's announcement to develop a real-time rail has increased awareness of the importance of real-time payments, banks still in the planning phases of real-time capabilities are somewhat confused about whether they should wait for FedNow to go live or if the timeline will be an issue, given that competitor banks will have the ability to implement the functionality first if connecting to the RTP system. Also in question is the interoperability of the FedNow system with RTP, leaving banks that plan to wait for FedNow questioning who they will be able to transact with if they are not able to capitalize on the volume and adoption of RTP—especially three to four years from now, given the increased activity and connectivity of banks coming in 2020.

In Europe, the adoption of real-time (or instant) payment mechanisms progressed rapidly in 2019 following the introduction in the Single Euro Payment Area (SEPA) of instant credit transfers (SCT Inst) in November 2017, and it has been implemented by 2,069 payment service providers across Europe. Adoption across the region has been complicated by the fact that SCT Inst covers domestic payments as well as cross-border euro payments within the eurozone. Several countries were already developing domestic real-time infrastructures, and several European Union member states (notably the U.K.—in the midst of the Brexit transition) are members of the SEPA zone despite retaining their own currency. The potential for this to hinder adoption of SEPA Inst was offset by the fact that it was mandated under EU law.

When it comes to use cases for real-time payments, most early adopter banks have been focused on initial launch activities and, in 2020, will start digging deeper into their portfolio to identify new use cases and ways to monetize the value real-time payments brings to their clients of all sizes. The easiest targets will continue to be clients with a high volume of low-dollar checks and businesses that have a high volume of low-dollar invoices for which payments need to be collected. In 2020, these clients will continue to be the largest generators of transactional volume, and we will see real-time solutions developed and marketed to augment and/or replace legacy bill pay solutions. The use cases in 2020 begin to transcend the big business use cases and reveal the value across business segments of all sizes, making real time important for small and midtier banks to bring into focus with their strategic plans and roadmaps.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

Because real-time payments were mandated by regulators, European banks have tended to focus on use cases more than the business case, a frame of mind that has been amplified by the Access to Accounts (XS2A) provisions of the EU's second Payment Services Directive (PSD2) driving the concept of API-enabled open banking. Two particular examples that are currently making waves and will come to the forefront in 2020 are (1) the use of virtual account management systems to provide improved balance information and reconciliation across accounts held at multiple FIs for corporate clients and (2) Request to Pay (RtP) messages. RtP provides billers with the ability to offer payees a range of options—pay now, pay later, partial pay, or start a dialogue. The European Payments Council's RtP scheme, supported by 26 payment service providers (mainly banks) in 11 countries, is expected to be live in the second half of 2020, with a separate U.K. RtP scheme later in the same year, though details of that are still to be finalized.

PAYMENT AUTOMATION BECOMES A GREATER FOCUS

By David Bannister

As domestic payment systems around the globe are modernized in the move to real time, at an international level, there is a risk of fragmentation. With efforts underway to create a global real-time payments system, this will affect how banks approach the critical issue of payments automation.

With electronic payment volume growing (the U.K.'s 11-year-old Faster Payments system is growing at 22% year-on-year according to industry body U.K. Pay), automation will become increasingly important in payments in order to eliminate failed or delayed payments, along with the associated costs of repair and customer dissatisfaction.

The industry is following several paths, all of which contribute to error reduction in different ways. One path is ongoing redesigning of banks' internal systems to replace multiple payment systems and silos to simplify processes and reduce errors. On top of this, increasing investment in AI technology, particularly the combination of ML and robotic process automation (RPA) in the areas of exception handling and repair, has begun to reap benefits for pioneers of the technologies, and this combination will see wider adoption in 2020 and beyond.

While redesigning internal systems will go some way to improve straight-through processing rates, the solution to other potential problems needs to be addressed at an industry level, and 2020 will see considerable activity in this area.

One of these solutions is the introduction of universal confirmation of payments on the SWIFT network, which will allow searching and tracking of all payments and allow banks to provide clients with more visibility on the status of their transactions. Pilots of the scheme have shown promising results: One bank in the Middle East reports a 95% reduction in customer queries with a corresponding cost reduction.

Also beginning next year is the start of a general migration to the use of ISO 20022 messages internationally. While a daunting project, the ability of the messages to carry richer data will be a boon to developing improved services to corporate clients and will also make it easier to automate transaction processing. Some countries, such as Canada, are designing their national-

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

level real-time payments infrastructure around ISO 20022 standards expressly as a means to increase automation and improve corporate payment capabilities.

Taken together, these are all steps in the right direction, but many issues relating to business and market practices remain, including the need to create new rulebooks that cover areas such as dispute resolution and the implications of the different settlement cycles behind domestic real-time payment schemes.

OPEN BANKING GETS MONETIZED AS API STRATEGIES ADVANCE

By Enrico Camerinelli

To keep pace in the corporate banking space with the speed of API evolution, FIs must identify the appropriate business models to address corporate needs, apply the proper pricing structures, and monetize the significant effort spent in developing commercial banking APIs. Retail banks still hold a lead role in API deployment since consumers tend to be early adopters of new technologies. In a relatively short period of time, though, Aite Group anticipates that commercial banks will overcome their retail counterparts and become the main developers of monetizable API-based solutions.

By “API-enabling” their treasury applications, banks with good treasury systems can offer quality services to third-party fintech partners that consume bank-centric data and services. Fintech developers can then further enrich these services and provide a better offering to their own corporate clients. Small to midsize enterprises (with revenue below US$300 million) are always in search of any solution that trims their operational costs, and API innovation gives them the option to apply solutions developed by experienced practitioners at a fraction of the cost of an on-premises software package.

Some small to midsize enterprises already run their treasury operations with an accounting software package. Aite Group expects banks will extend these basic accounting functionalities by connecting them to their own back-office core banking applications with APIs—possibly developed by a fintech partner. Banks will gain a strategic position by leaving the accounting software providers to care for the applications that manage cash forecasts, liquidity, receivables and payables, profit and loss, tax payments, and payroll, which are not truly a bank’s business. The bank will maintain control and delivery (at a premium) of the back-office data flows that the accounting software needs to access. Realistic banks know that small to midsize enterprises expect an innovative culture and approach from their software providers and from their own bank. By allowing an intermediary to step in between the bank and its clients, the bank loses the direct customer contact but increases the possibilities to expand its offerings of products and services given that, by navigating through the bank’s applications with increased satisfaction, the client may be more available to exchange personal data and preferences for value-added services. Thus, increasing sources of data enable the bank to achieve more realistic, improved, and effective profiling analytics.

Consider corporations with annual revenue above US$300 million. The API matter is serious for banks, because these clients are demanding to consume financial supply chain applications

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

directly from their own enterprise resource planning (ERP) or treasury management system (TMS)—even though corporate users are not interested in whether such seamless integration comes from APIs or from another solution. APIs help bank sales representatives build partnership-focused relationships with their corporate clients. The banks' sales representatives are getting more aligned with the corporate market dynamics, because clients that enjoy using APIs to access new applications provide continuous feedback that opens the door to more context-driven insight on how they use bank products.

The key strategic decision for commercial banks is how and when (and whether) they should price and commoditize these API-based products and data-driven services. Traditional models base the pricing unit on file transfers and related operations. The real-time nature and multiplicity of applications that APIs make available for consumption force banks to move away from a file-centric concept. APIs enable a corporate user to get multibank account balance data directly into its front-end system, whether a basic accounting software package or a more sophisticated ERP or TMS. How can the bank (or the fintech partner) charge the client once the consumption moves from single data to context-driven process life cycle transactions?

A transaction-based model would charge a fee for each time the button is clicked, but in this new scenario, that approach would only disincentivize usage. The pricing unit of value shifts from the data contained in the file to the ease of access, the simplicity of use, the richness of the context-driven information, the completeness of the functionalities made available to analyze and process the data, and the assistance to execute all the steps of the value chain workflow. The distribution of bank products is changing to an "API first" model as the next step in the evolution of bank distribution models. Banks will leverage APIs to capture market share and retain customer loyalty rather than immediately using them as a monetization asset. Banks will develop APIs to build critical delivery of context-driven channels for data and services most desired by corporate clients. While the delivery channel (i.e., the API) itself is not monetized, the underlying context-driven data, product, solution, and service will be monetized.

AI BECOMES A REALITY BEYOND FRAUD PREVENTION

By Gilles Ubaghs and David O'Connell

The hyperbole surrounding AI-related technologies, including areas such as natural language processing, analytics, and ML, will continue to give way to a period of greater implementations, live rollouts, and understanding of AI in 2020. The market is finally moving away from demands for a generic AI solution to "improve" services, into a more considered approach of what various AI technologies mean from a product, service, and implementation level, and healthy levels of skepticism are likely to increase among many institutions as they get a better grasp of what the technology can do for their business.

Understanding of AI is improving across the financial services sector, but it remains highly variable between institutions and, indeed, within them. This uneven level of knowledge is increasingly problematic for banks as growing numbers of their corporate and business customers seek out their financial service providers for guidance on AI technologies and what they mean for them, while also leaving banks at risk of implementing unrealistic solutions that do not match vendor claims. As a result, it is imperative that banks work to improve

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

understanding of AI across their workforce. Furthermore, the war for talent and resources in developing AI will remain a struggle across the financial services and technology space. Most banks will have no option but to continue partnering with third parties and keep investing in developing talent.

The use cases for ML and other related technologies are now rolling out into multiple product areas simultaneously, and development is not limited to a single field or use case. As a result, banks will increasingly experience multiple AI-related initiatives developing on an ongoing basis. These use cases notably include ongoing advances in fraud detection and prevention in which ML technologies have long been in use but continue to advance at a startling pace. Natural language processing and digital assistants are also likely to remain high-profile areas of development, with banks quick to tout their corporate customer-facing solutions, but back-office implementations will remain just as impactful in areas such as relationship management, intelligent search, and customer relationship management uses.

A growing variety of solutions using RPA have the potential to generate considerable efficiencies for banks and clients, lowering costs and increasing rates of automation and integration into the broader digital environment. Automation will remain a critical point of AI implementation in the near term, with major impacts on everything from onboarding to increasing straight-through processing rates. Analytics remains potentially the most impactful, but also difficult to predict, focus of AI development. With use cases ranging from cash forecasting, customer analysis, personalization, and recommendation engines, the applications of AI-powered analytics are seemingly endless. Underpinning this potential, however, is the need for good data management strategies, and this will continue to be a major strategic consideration and potential stumbling block for commercial banking in 2020.

Over on the business lending side of commercial banking, embracing AI—although achieved mostly as the result of third-party capabilities rather than in-house innovation—is well under way, with hype long since ignored, and AI implementation can be expected to accelerate. In 2020, expect to see more banks using AI for loan sourcing, financial spreading, and fraud detection, with the more mature adopters propagating benefits of such technologies across more challenging use cases and to new lending lines of business. Seen by Aite Group as on deck for adoption in 2020 are the applications of AI in business lending to a variety of next-best-action types, identification of more business collateral against which to securely book loans, and earlier detection of borrower credit-quality deteriorations. But, as with the adoption of most flavors of analytics, a scarcity of skilled data scientists will place a limit on institutions' ability to succeed with AI and confer leadership status to those best able to close their knowledge gap with successful recruiting.

PREPARATION BEGINS FOR POSSIBLE RECESSION AND NEW MARKET DYNAMICS

By David O'Connell and Gilles Ubaghs

Although the four riskiest words in economic analysis are "this time is different," the same number of parameters are sure to be unique about the next economic downturn for banking, which can be expected to be characterized by the following:

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

- **Intense anticipation:** The next recession and its attenuating credit cycle denouement will be among the most anticipated in economic history. Its timing and severity are regularly and intensely the subject of inquiries made by institutions of industry analysts, such as the authors of this report. It's one of the most discussed topics among journalists and the talking heads of the financial world. In particular, banks want to know when other banks think it will happen and how they are preparing.

- **Systemic prevention:** Since the global financial crisis of 2008, new regulatory and accounting regimes—in the forms of Dodd-Frank Act stress testing and International Financial Reporting Standard (IFRS) 9, the local instantiation of which is the Financial Accounting Standards Board's (FASB's) Current Expected Credit Loss accounting standard—have been aimed at detecting and mitigating risk at both the systemic and micro levels of the credit markets.

- **Favorable demographics:** Occupying many of the cubicles in commercial banking in general and commercial lending in particular—and likely to do so for still more years into what would have been their parents' golden years for retirement—are a large contingent of baby boomers. This is an economically cynical professional demographic that has survived a succession of steadily more severe financial bubbles: the oil and residential real estate collapse of 1989, the internet and Y2K bubbles of 1999, which all look like a walk in the park compared to their successor, the global financial crisis of 2008. Some finance professionals were even close to the near catastrophe of the collapse of Long-Term Capital Management in 1998. Although this is no economic panacea, it's possible that today's financial markets are peopled by the most wizened and jaded financiers in history.

- **Near pervasive analytics:** Assisting boomers in their preparation for the next downturn are analytics tools that are more pervasive and affordable then they were in prior cycles. Ready availability of risk analytics, whether in the form of canned reports from vendors or ad hoc queries from inquisitive and data-savvy risk managers, means that this time around, it will be easier for deteriorations to be seen earlier, be they at the sector, portfolio, or borrower level.

While some demographics, new skill sets, and infrastructural protections paint a strong picture for the industry, two concerns remain. First, there are insufficient risk returns. Successive rounds of quantitative easing by central banks, including in the U.S., have let loose too much capital, which is chasing too few loans. Which, of course, causes prices to go down. So much so that commercial bankers commonly refer to commercial lending as a loss leader. Not getting paid for your risk when lending to companies is surely a concerning sign of a market top. Second, not all banks are able to compensate for insufficient risk returns in commercial lending. After all, it's the profitability of noncredit services, such as treasury management, payments, and corporate cards, that pad the profitability of commercial lending banks. But such capital-enhancing products tend to be available only to larger banks possessing both relationships with large fintech firms and skill sets required for cross-sale of these products to corporate borrowers.

Commercial cards are likely to prove a front line in any business-spending slowdown brought about by economic shocks. While economic softness would undoubtedly weaken commercial

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

card transaction volume, and some early indicators in late 2019 suggests this may already be the case, banks should be wary of limiting their investment in commercial card-related products and technologies. While slowdowns in spending directly impact commercial card revenue, appetite for commercial cards (due to their ability to attract rebates for buyers as well as improve straight-through processing rates) means the way businesses pay will continue to change even if budgets for major digital transformation projects take a beating. The demand for more cost-effective and efficient payment tools may in fact rise if businesses are forced to retrench in any capacity, and pursuing this cost-effective messaging should prove impactful for commercial card issuers.

CLOUD ADOPTION CONTINUES

By Erika Baumann

Cloud technology used to be shrouded in mystery, and the banking industry considered the cloud to be taboo and insecure. However, as with all good mysteries, the veil has been lifted, and the value and security of the cloud is becoming clear. The demand for greater architectural flexibility, quicker speed to market, and identifiable cost efficiencies that the cloud can provide has thrust cloud technology into the spotlight. Leading cloud providers have focused on advancing and marketing the security of the cloud to ease concerns about data integrity. Throughout 2019, big cloud vendors such as Microsoft, Google, and IBM helped propel banks into the technology headlines with partnership and investment announcements. With the biggest banks investing heavily in cloud technology, the possibilities that the cloud provides have gotten the attention of banks of all sizes. Banks are no longer asking if cloud technology should play a role in the strategic future, but how.

There are two sides to the cloud: utilizing cloud technology for internal systems and utilizing cloud technology for vendor solutions and partnerships. While some of the biggest banks have moved some internal systems to the cloud, the trend headed into 2020 is to focus on more on the external applications. Banks are seeking out technology vendor partners that can help ease the time and costs of implementation by utilizing the cloud. Because of this, some of the benefits of the cloud are helping to even the playing field for small and midsize banks trying to compete with the largest national and global banks. This is especially true in commercial lending, where a cloud option is almost a requirement for a vendor to be considered for providing automation for loan origination. And a leveling of the playing field is indeed a result here. After all, a pay-by-the-asset cloud deployment means that a US$3.5 billion bank has access to almost the same productivity-improving technologies as a US$35 billion bank.

In 2020, the cloud will continue to play a critical role in advancing banking technology. Banks' strategies will become more concrete in how the value of the cloud can be exploited. Notably, Aite Group estimates that cloud implementations cost 30% to 40% less than on-premises implementations. The valuable time and resources that are freed up with this savings allows banks to focus on additional strategic initiatives, creating a new and improved development cycle that has the potential to bring new features and capabilities to bank customers quicker and on a greater scale. The cloud has come at such an important time in the financial industry as banks have struggled to keep up with shifting expectations across critical functional and operational areas, such as onboarding, cash management, payments, automation, digitization,

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

and bill pay. Even the largest institutions are challenged to remain competitive and at the top of the industry with the quick pace and complexity of new technology expectations. Headed into 2020, however, the cloud plays a significant role in removing some of these constraints. Even capabilities that would have been very hard or impossible for smaller institutions to fund are now able to move forward, creating an even more competitive landscape for FIs across all segment sizes. Banks that are not considering how the cloud can create strategic advantages for them in 2020 will certainly find themselves at a disadvantage.

NEW OPPORTUNITIES FOR BANKS AND TECHNOLOGY VENDORS EMERGE

By David Bannister

Corporate banks are increasingly looking to leverage the opportunities presented by real-time payment networks and API-enabled open banking to develop innovative new services and enhance their existing offerings to an increasingly demanding client base.

At the same time, they are also more willing to deploy vendor solutions than they have been in in the past and, in turn, payments and core systems software vendors have been busy developing their own product portfolios to cover emerging areas such as request-to-pay mechanisms, universal payment confirmations, virtual account management, and wider adoption of the ISO 20022 messaging format, leading to data-driven payment services.

Importantly, as discussed in more detail elsewhere in this report, corporate banks have begun to embrace the need to replace legacy systems with modern architectures based on open systems and cloud computing, putting aside previous concerns such as security in exchange for lower operating costs and shorter time-to-market cycles in product and service development.

For financial services software vendors, this means completing their own replacement of existing products with cloud-native versions rather than simply offering managed services using versions of existing software running off-premises. For several years, the established financial services software vendors have been moving in this direction at different speeds, largely dictated by the needs of their existing customer bases. Most have also split modules into various components from their product portfolios and made them interoperable with competitors' systems. This will become important as the banking ecosystem develops and banks pick and choose products and services from a wider range of suppliers, including newer fintech vendors.

The move to replace legacy systems, driven by both the demands of real-time payment processing and the need to reduce costs in the face of falling margins, also presents opportunities for the traditional IT suppliers and cloud service providers. After ramping up their marketing efforts over the past year, we can expect news of implementation projects throughout 2020.

In the near future, however, one issue that banks will have to be wary of is the potential lack of diversification that adopting off-the-shelf solutions will bring. Beyond the operational improvements and cost savings, the aim of systems modernization is to sharpen banks' competitive capabilities: How they build, package, and market new products and services in a way that differentiates them from their competitors will be a critical factor in future success.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

DIGITALIZATION BECOMES BOTH EXTERNAL AND INTERNAL

By David O'Connell

Among all bank clients, it seems that corporate borrowers have been last to benefit from FIs' embrace of digitalization. Dominating and clogging the loan life cycle, as well as day-to-day processes after the close, are cumbersome processes for providing financial statements, updating guarantor data, changing borrowing terms, and other due-diligence-related tasks. For many such tasks, borrowers are yet to benefit from the types of drag-and-drop digitalization or ease of use long available to consumers.

But the clunkiness can expect to soon be worked out of the corporate client borrower experience—and yes, the term "borrower experience (BX)" can soon be expected to enter commercial lenders' lexicons. When recently asked about how well their commercial loan origination vendors support their digitalization efforts, lenders had an interesting take on digitalization. First, lenders indicated that they were yet to adopt digitalization technologies readily available from their vendors. Despite this, digitalization was clearly a priority; it's on their 2020 and 2021 roadmaps, and they were reticent, almost ashamed, in describing their late adoption. Lastly, believing that they could digitalize the BX if they digitalized the experience for the borrower-facing employee, lenders exhibited a somewhat flawed understanding of digitalization.

Borrower demographics will necessitate an acceleration of proper digitalization of the BX by business-lending FIs. Beginning to dominate corporate borrowers' C-suites and controller departments are millennials: folks who grew up doing just about everything on a handheld device, often over social networking. Although they want to have a personal relationship with the individuals and institutions from which they acquire credit, from these they also expect convenience and hyperconnectivity. The sooner these are delivered, the sooner a lending institution can expect to be the lending FI of choice.

And the sooner lenders deliver a digitalized BX, the sooner they can focus on being trusted advisors—a critical path to invoking real loyalty and reducing price sensitivity. Let's face it, borrowers don't want to spend time with loan officers on financial statements, borrowing bases, and insurance; they want advice and partnership. They want their lenders to be trusted advisors, with a capital "T" and a capital "A." Areas where lenders, individual and institutional, can begin being a trusted advisor are many: providing borrowers with information about the vertical in which they operate, introducing borrowers to peers from whom they can get advice, and advising controller departments about how to avoid falling prey to financial crimes.

Anyone who thinks lenders can't be a valued trusted advisor should consider deeply the following anecdote. Recently at an industry event attended by agricultural lenders, the author—attending in the role of speaker and subject-matter expert—was asked the following question by a lender:

> A lot of our dairy farmers are really getting into dire financial straits because of trade conditions that are causing bankruptcies that are the first in generations. And family farmers have begun committing suicide. Do you know how we lenders can access employee assistance programs for such folks?

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

Readers thinking that lenders can remain focused on hand-holding in face-to face, operational interactions and can't deliver powerfully in the role of trusted advisor, in which they have the potential to assist in suicide prevention, should think again.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

CONCLUSION

In 2020, Aite Group anticipates the following trends in wholesale banking and payments:

- **Usability trumps functionality:** Leading institutions will need to make such enhancements a priority or risk looking dated and face challenges attracting and retaining customers.
- **Cash and liquidity products move down-market:** Opportunities exist for banks to offer scaled-down versions of products once reserved solely for their largest customers to meet the new needs of a more sophisticated customer base.
- **Real-time payments shift from "if" to "when" as new use cases emerge:** Significant numbers of community banks and credit unions will have connectivity into the RTP network, highlighting the value of real-time payments for businesses of all sizes.
- **Payment automation becomes a greater focus:** As real-time payments become the norm domestically and globally, improved payment automation becomes critical for banks. Redesigning existing internal systems is one step, while ML and RPA promise significant improvements.
- **Open banking gets monetized as API strategies advance:** It is a priority for banks to plan for the right change management program that will help them agree on what an API strategy is, what it can solve, and why it represents a benefit to the bank. Banks are under pressure to grow revenue and reduce expenses. A bank incapable of measuring how an API program may address these objectives faces significant constraints to deploy a competitive strategy.
- **AI becomes a reality beyond fraud prevention:** Simply shouting AI in marketing materials is no longer sufficient, and AI development is increasingly critical in terms of product development and back-office efficiencies. Partnerships and talent development will remain critical for everyone.
- **Preparation begins for a possible recession and new market dynamics:** While the next recession might be the most anticipated and prepared for in memory, an over-supply of capital has rendered business-lending FIs uniquely vulnerable. Expect the survivors of the next recession to be those with the high-margin noncredit products that pad a lender's equity.
- **Cloud adoption continues:** The cloud allows banks of all sizes to experience greater flexibility, quicker speed to market, and operational efficiencies. Banks that are not exploring the value of the cloud will find themselves at a competitive disadvantage as technology solutions become more accessible to even the smallest banks.
- **New opportunities for banks and technology vendors emerge:** Corporate banks are looking to leverage the opportunities presented by real-time payment networks and open banking to improve their products and services. As they turn to vendors to help them, they must avoid the trap of having "me too" products and differentiate themselves in the market.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

- **Digitalization becomes both internal and external:** Millennials are beginning to dominate the controllers' departments and C-suites of corporate borrowers; expect business lending FIs to respond by digitalizing the BX, enabling lenders to spend more time as trusted advisors.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

RELATED AITE GROUP RESEARCH

The Payments Transformation Race: Criteria for Success, September 2019.

AI in Business Lending, August 2019.

Artificial Intelligence in Wholesale Payments: Five Use Cases, July 2019.

Time for Action! Making the Business Case for Real-Time Payments, July 2019.

Corporate Banking API Strategies and Monetization, May 2019.

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com

ABOUT AITE GROUP

Aite Group is a global research and advisory firm delivering comprehensive, actionable advice on business, technology, and regulatory issues and their impact on the financial services industry. With expertise in banking, payments, insurance, wealth management, and the capital markets, we guide financial institutions, technology providers, and consulting firms worldwide. We partner with our clients, revealing their blind spots and delivering insights to make their businesses smarter and stronger. Visit us on the web and connect with us on Twitter and LinkedIn.

AUTHOR INFORMATION

Christine Barry
+1.617.398.5040
cbarry@aitegroup.com

Wholesale Banking and Payments Team

CONTACT

For more information on research and consulting services, please contact:

Aite Group Sales
+1.617.338.6050
sales@aitegroup.com

For all press and conference inquiries, please contact:

Aite Group PR
+1.617.398.5048
pr@aitegroup.com

For all other inquiries, please contact:

info@aitegroup.com

© 2020 Aite Group LLC. All rights reserved. Reproduction of this report by any means is strictly prohibited.
101 Arch Street, Suite 501, Boston, MA 02110 • Tel +1.617.338.6050 • Fax +1.617.338.6078 • info@aitegroup.com • www.aitegroup.com