Achieving peak performance in payments

As margins erode and new, more agile challengers enter the payments market, banks are facing some difficult decisions about how to compete. *Future Banking* talks to Vincent Kilcoyne, executive vice-president for product management at **SmartStream**, about how AI and machine learning can help both banks and their new competitors to make the most of a fast-changing market.

From a customer perspective, the payments space is vastly different to how it was just a few years back. Cash payments are far less common, and the market is defined by a proliferation of banks and fintechs providing payment services. In the digital payments arena, choice is the buzzword. This brings many opportunities for every kind of service provider.

"When you talk about financial institutions it is important that you break it into two worlds: banks and non-banks," says Vincent Kilcoyne, executive vice-president for product management at SmartStream. "It may be unpopular to say it, but payments are a very high-performing segment for banking but not necessarily for banks."

"If you look at where the lion's share of payments is happening now, you are seeing a huge amount of growth in the non-bank area, with the likes of GoCardless and Worldpay," Kilcoyne continues. "Payments is a bifurcated market – it touches the front office, which captures and processes payments, and the back office, which handles compliance and other functions. But the question is, who handles other areas like fraud surveillance and customer intelligence?"

The world of fintechs and non-banks is changing fast, and consolidation is the driving force. Back in 2019, international financial services technology and outsourcing services provider Fidelity National Information Services (FIS) acquired Worldpay, a leading global e-commerce and payment technology company. The deal created a company with more than $12bn in revenue, making it one of the major providers of technology and solutions for merchants, banks and capital markets.

Vincent Kilcoyne, executive vice-president for product management, SmartStream

In 2020, meanwhile, French payments Worldline completed an $8.6bn acquisition of Ingenico to create the biggest merchant acquirer and payments processor in Europe. It followed that in 2021 with the acquisition of Cardlink, a major network services provider in Greece, and then with a deal for Handelsbanken's card acquiring activities in the Nordic region, as part of an ongoing consolidation strategy across Europe.

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Whether in Europe, the US or Asia, the payments landscape is changing fast, and this consolidation brings challenges not only for banks, but also for the non-banks and fintechs that are growing rapidly in both size and reach through these mergers.

Size brings challenges

For banks, the big difficulty of a rapidly evolving market and the opening up of the payments space to new players is the impact on their bottom lines.

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Customers, after all, now have more choice than ever before. They can shun their traditional banking partners and simply switch to one of the relatively new market entrants that offer cheaper or more convenient services, be it Monzo, Starling, Atom or any other, while still using their old bank for other services. Customers have more freedom to decide where and how they do business, and where, how and with whom they spend money. Inevitably, many jump to a non-bank that offers lower prices and better services.

In short, is it inevitable that banks will lose out to new, more agile players who are not encumbered by the legacy systems architecture in which banks have invested millions of dollars and on which they still rely heavily.

"Payments are seen as a commodity," Kilcoyne stresses. "And that is predicated

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on having the systems in place, having a single data source and being able to do something with that data. The beauty of payments is that if I'm an organisation that provides access to payments services, I know more about the customer than their bank – what you spend, where, and who with."

"That data is an incredibly valuable asset but you need to put it in one place with one set of control procedures to get insights from it, control costs and build analytical models and start to have high-value fraud alerts, for example, based on a real understanding of individual customers," he continues. "Payments is the on-ramp to value-added services. Customers want fraud alerts instantly and merchants want a high success rate and want to know that the payments providers have the right infrastructure."

In other words, banks do have some advantages. For instance, different geographical regions embrace mobile payments at different speeds. The UK, western Europe, Asia and Scandinavia are all engaging at different speeds. That means a provider needs many different technologies to satisfy global agenda and regional differences in adoption rates – meaning banks enjoy a head start.

"Non-banks have an interesting problem in that the volume growth they are experiencing is substantially ahead of the predictions they made a few years ago," says Kilcoyne. "So, they have point solutions to address particular volume projections, and they have worries about what happens if things go better than planned.

"The controls, processes and systems they have are actually not satisfying the demands of global penetration and of their unanticipated growth," he adds.

SmartStream assists some of the world's largest banks – and many non-banks and emerging fintechs – with payments processing. It provides a digital payments solution that automates reconciliation, settlement, fee calculation and dispute management processes for market participants of all kinds, so it sees the problems and the opportunities from both sides.

"Banks have a technical legacy debt, but they have put in place mission control and enterprise capability that fintechs and non-banks have not, though they use newer technologies to address those problems," Kilcoyne says. "Non-banks often acquire companies that have different solutions that may not be enterprise-ready, so may have to talk to us at SmartStream to help them with global support and regional level control and enterprise capability."

The application of AI

A hallmark of SmartStream's approach is the application of artificial intelligence (AI) and machine learning (ML) to specific pain points in the financial transaction lifecycle. These technologies are capable of supporting both large banks and small fintechs in streamlining the payments process.

"Fintechs and non-banks are having to go through some of the same problems that banks went through," Kilcoyne explains. "These are multi-disciplinary problems, and one part of it stems from the software components, and another part is global experience. We may have more experience of global market operations and regulations than some of the fintechs themselves, so we can help them position themselves.

"We also have a lot of experience of the challenges that larger organisations face in terms of diversification, and in an environment where regulations are becoming more strict our solutions must always be compliant and ready for inspection by auditors or regulators," Kilcoyne continues. "Fintechs benefit from solutions prepared for large T1 banks, and the rigour and oversight that demands."

At the same time, the company offers an in-depth understanding of the financial services market. It appreciates the industry's reliance on high-quality data – and the business problems that data can help solve.

"We call it 'domain recs' – domain reconciliations – which derive from specific use cases and the provision of functionality to solve specific business problems," says Kilcoyne. "For example, organisations usually do a point-to-point reconciliation: matching a debit to a credit. But what happens when they need to match one to many or many to one? How do they match the corresponding transactions? We do that for all kinds of securities and for many other asset classes.

"With us, fintechs can leverage big bank DNA," Kilcoyne continues. "Banks are always involved somewhere in the chain, so they benefit from knowing that all the other elements in the chain are well controlled. That improves both their operational overhead and their risk profile. It creates a more elegant ecosystem. The data is everything, and it helps to know it is clean and well controlled."

SmartStream first helps to ensure that high-quality data is generated throughout an organisation. This data can then be fed into analytical models powered by AI and ML, helping it spark meaningful insights – and positive customer outcomes.

"Any analytical model is only as good as the data used to calibrate it in the first place," Kilcoyne explains. "That is what we specialise in and we pride ourselves on our rich data control infrastructure. Organisations that provide payment services know a lot about customers, but ML models help them to learn more about customers and their behaviours."

"They create an ecosystem that provides corporate intelligence and customer intelligence, which creates a virtuous circle," he adds. "The models give organisations more intelligence, so customers give them volume, which enables better services such as fraud detection. With data you get facts, not opinion. ML models help an organisation learn and improve to deliver better outcomes with shorter lead time."

SmartStream prides itself on never using AI or ML for their own sake – but only when

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they solve specific problems. Every use case must pass the relevance test and reinforce the core value in the company's DNA. In practice, that means improving decision-making and generating competitive advantage through the operationalisation of data.

"That is about the benefits of being curious," emphasises Kilcoyne. "That is where AI and ML trump everything: they have no bias, they are impartial, they may tell you things you don't like, but they always generate the next question and highlight the next area for improvement."

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Progress through partnership

AI and ML not only help to generate better insight from customer data and, therefore, drive value-added services such as fraud detection, but they also enable the automation of key processes such as reconciliation.

"A key driver is manual touchpoints – MTPs – and each instance generates additional cost or margin erosion," says Kilcoyne. "We have built AI models that reduce MTP by a large percentage. That changes the cost model and enables organisations to redeploy people to higher-value operations.

"For banks and non-banks, our operational DNA is the key to operating economically and profitably," he adds. "The key to change is to have agile operations, so we have engineered our solutions to deliver that flexibility. The single biggest differentiator with SmartStream is that we understand how to bring in AI as part of our control structure."

AIR, for example, is an AI-powered reconciliation platform that can match any data set, either structured or unstructured, in a matter of seconds. Affinity, for its part, is an ML-powered observational learning tool that can understand and implement the workflows of individual users. That ensures key processes only require human input in the management of exceptions.

"Our solutions are about more than just matching data," says Kilcoyne. "They are about enabling control procedures and ensuring transparency and visibility. We bring deep subject matter expertise and critical and analytical thinking to help organisations position themselves for success."

Whatever stage of development a payments services provider is at, it needs solutions that have been developed to meet the challenges of tomorrow. Listen to Kilcoyne and it is clear this is what SmartStream was built to deliver. ●

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