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Payments trends

Contents

Introduction

The payments industry is experiencing a period of profound, rapid change initiated in part by the global pandemic and sustained by the more recent impact of bank failures.

Financial institutions (FIs) now need to take stock and assess the changing macro environment. Over the past three years alone, payments have taken a new shape, morphed by the acceleration of digital adoption, the shift toward real-time payments, the increased comfort of omnichannel contexts, and the newest tech innovations taking hold including biometrics.

Is this period of rapid hypergrowth sustainable? If not, where should investments be prioritized across product, operations, technology, and workforce? This new world is ripe with opportunities to grow, but these opportunities can only come to fruition for those institutions that rectify gaps in their foundations across tech, fraud, and the workforce.

Digital adoption has seen unprecedented adoption rates over the past few years, opening the door to new innovations on the horizon

Digital payments capabilities were set on a path of rapid adoption during the COVID-19 pandemic due to unprecedented physical limitations, changing customer demands, and increased comfort with and acceptance of digital identity.[1] Digital technology is now engrained as a fundamental aspect of payments models. Organizations are heavily incentivized to leverage and embrace next-generation money-moving technologies and digital-native capabilities to remain competitive.

Increases in mobile payments and use of digital identity are examples at the forefront of new digital preferences for customers. The mobile payments industry anticipates continued growth with an expected CAGR of 26.93% from 2020 to 2025.[2] The use of biometrics in payments (e.g., fingerprint, eye scan, 3D face mapping) has also continued to grow, adding to the overall power of digital identity as a tool. The global biometric payment cards market size is projected to reach $5.8 billion by 2030 with a CAGR of 63% during the forecast period (2023–2030).[3] Continued maturity of digital identity will likely, in turn, power downstream capabilities including omnichannel contexts for a holistic customer verification experience. Increased access to digital payments technologies and the increasing presence of those technologies in nonfinancial industries[4] could further reinforce new market norms.

As customer behaviors shift, companies will need scalable, flexible digital solutions that meet the minimum customer expectations and enable them to respond quickly to the market. As more fintechs enter the digital payments market and work to capture traditional financial institutions' market share, FIs should rapidly build and, more importantly, iterate upon their digital capabilities to avoid being left behind and remain competitive.

Real-time payments technologies have developed a strong foothold in the market amid increased demand and fast-tracked customer comfort

Real-time payments have been around since 2015. The Real-Time Payments Network (RTP or RTP Network), introduced by The Clearing House in 2017, initiates and clears payments within seconds 24/7/365 (including holidays and weekends). Customer expectations for payments to move instantly are now at an all-time high. The COVID-19 pandemic accelerated market adoption as financial hardships increased people's need to receive faster access to money, including wages. Consumers and businesses were also prompted to limit their use of physical cash and bank notes, underscoring the necessity for real-time payments adoption. The resulting incremental pressure and special focus on providing instant, contactless, and electronic payments accelerated the buildout and adoption of real-time payments.

Over the past three years, RTP activity has steadily risen with a "12% volume growth and 18% value increase from 1Q23."[5] The Federal Reserve launched FedNow, the first new rail since RTP, in July 2023. One of the biggest differentiators between FedNow and RTP is its integration with the Federal Reserve's network to increase consumer accessibility. All member banks have access to FedNow as well as non-member state banks if they meet certain requirements.

Real-time payments remain in the fast lane in the United States, with significant year-over-year growth of 69%. Incumbent payments networks are adding incremental features, fintechs are launching customer-facing apps, and new real-time payments rails are under development to address the projected volume and demand over the next five to 10 years.

Crisis or no crisis, real-time payments transformation has found its foothold in the marketplace. The competitive landscape is redefined by the evolution of new solutions provided by FIs and the development of strategic alliances that cut across traditional sectoral boundaries. We are confident that the future payments ecosystem will include globally integrated clearing-settlement frameworks and open platform channels that offer maximum customer access, adaptability, speed, ubiquity, and comfort. The biggest challenge ahead may not be enabling this functionality, but its implications inclusive of harder-to-recover fraud and instant ability for customers to react (i.e., causing a run on the bank).

These converging trends have led us to a pivotal moment of change to bolster the foundations

The recent and projected accelerations in adoption of both digital and real-time payments have created vulnerabilities in the payments ecosystem. As these payment methods mature, stakeholders including FIs, payments facilitators, and regulators should ask themselves three primary questions to identify gaps in their end-to-end payment processes:

1. What investments are needed to strengthen and modernize technology and operations infrastructure to allow for continued innovation?
2. How can we mitigate fraud risk and losses as transaction speeds increase?
3. How do we ensure our workforces are adequately equipped to support these new payment methods?

After rapid change, platform modernization is needed for future tech enablement, especially considering the ISO mandate

Payment providers should evaluate their technical foundations to help ensure they can enable safe, frictionless payments for customers demanding a frictionless experience. As systems and data become increasingly complex with rapidly evolving payments trends, it is critical for the industry to establish universal standards for all financial institutions. The Clearing House and FedNow are paving the way as the leading instant payments rails, but there is so much more to consider as institutions look internally at their holistic infrastructure. If the infrastructure cannot support iterative change, institutions lose their agility and positioning in the market.

ISO 20022 is an internationally recognized standard, developed and maintained by the International Organization for Standards (ISO), for financial industry messaging in payments, securities, trader services, cards, and foreign exchange domains. The standard provides a common language and model for payments data, thereby improving data quality across the payments landscape. ISO 20022 data standard adoption is helping banks better understand their customers and how best to serve them, which can ultimately create better industry outcomes. Furthermore, the new standard will enable a range of potential benefits across each bank, improving operational efficiency and lowering costs associated with payment processing.

While adapting to these new standards, FIs should continue to innovate to meet rising customer expectations (e.g., leveraging artificial intelligence [AI] to answer natural language queries). With the rapidly evolving payments space, banks are struggling to keep up. The migration of global and regional payments networks to ISO 20022 alone poses a considerable challenge, requiring significant technology lift to integrate with legacy systems that may not be compatible with the new data structure.

Although a heavy investment, modern technical platforms will be required to enable future advancements in cloud, generative AI, quantum computing, and 5G, which, in turn, will be needed to provide expected 24/7/365 performance. If incumbent payments providers ignore the ISO 20022 standard and other innovations on the horizon, they run the risk of only doing incremental, minimum viable releases.

Next-gen solutions will be at the forefront of combatting new fraud and scam strategies

The increased speed of transactions and popularity of peer-to-peer (P2P) payments and transfers has led to increasing fraud losses year over year, with 2022 ending in $1.76 billion in losses, nearly double the $893 million in losses reported to the Federal Trade Commission in 2021.[6] Increases in fraud are driven by two primary forces: an increase in the adoption of P2P payments and an increase in the prevalence and sophistication of fraud schemes.

Schemes by bad actors typically fall into one of two categories: fraud or scam. Fraudulent transactions are typically generated by external actors who have gained control of accounts, credentials, or identities to impersonate the customer and initiate transactions. Scams generally include transactions initiated and authorized by the customer under false pretenses and are also known as authorized fraud. Historically, financial institutions have covered consumer losses for fraud but not scams, although scams are garnering both more industry attention and regulatory scrutiny. While there are indications that the Consumer Financial Protection Bureau may amend Reg E to compel FIs to reimburse victims for P2P payment scam losses,[7] there is pending legislation in the US House of Representatives to provide clearer guidelines.[8]

With new payment rails launching and payment speeds increasing, fraud and scam types are evolving. Increasing prevalence of personally identifiable information (PII) breaches have led to troves of identity data available to fraudsters over the dark web. Over the past decade, the five largest publicly reported data breaches have resulted in the compromise of more than 1.3 billion PII records.[9] Fraud and scam detection strategies should consider FIs' ability to leverage modern technologies including device fingerprinting, behavioral biometrics, and AI-based anomalous transaction behavior modeling.

FIs are increasingly investing in and deploying new technologies including machine learning (ML) and AI to combat fraud. While players such as Featurespace and Signify offer third-party solutions to fight fraud, banks are developing anti-fraud capabilities in-house. FIs using AI and ML technologies report lower rates of fraudulent transactions,[10] making the increased focus and investment worthwhile. While FIs have made strides, they cannot mitigate fraud alone. Payments giants including Mastercard have announced partnerships with FIs to leverage AI and their payments data to mitigate real-time payment scams before funds are transferred.[11]

Considering these new and emerging payments technologies, all players within the payments ecosystem need to build fraud protection within the technical modernization journey currently in motion. This means building solutions compatible with recent digital solutions, instant rails, and ISO standards that are leading the industry as well as aligned to the next generation of fraud solutions. Without best-in-class fraud protections, institutions will likely see a direct impact to year-over-year fraud losses and exposure to breaches.

Workforce management should emphasize a skills-based approach to support new payments technologies

There is a demand in the market for workforce agility, agency, and equity, particularly as it relates to financial services and the payments industry. To meet these demands, a greater emphasis will be placed on a skills-based approach to manage work and workers. As firms invest in new technologies, they will need to continually upskill their workforces to achieve expected returns on their investments. Research shows 96% of payments and financial services executives recognize that the traditional job title and job description approach to organizing employees is not effective in today's fast-paced and constantly evolving business environment. However, only 21% believe their organization is ready to transition from a job-based infrastructure.[12]

Shifting to a skills-based approach will be important as payment organizations transition to new technologies, processes, and platforms.[13] For example, a greater emphasis on real-time payments will warrant a new set of appropriate skills across payment functions including for fraud, customer experience, risk management, sales, etc. Resources that are highly competent when it comes to legacy products (e.g., lockbox or remote deposit capture) may experience a steep learning curve when presented with emerging payments technologies. Organizations should reevaluate their teams' training needs early and often to ensure workforces are fully prepared to operate, manage, and sell API-first and other digital-first payment solutions as they are delivered. Organizations should begin to act by defining the work and tasks required to complement industry-led trends and integration points across the talent life cycle. When compared to other industries, payments and financial services executives feel less prepared to match worker skills with organizational priorities in ways that are not defined by job responsibility. They see "infrastructure and technology" as a much greater barrier to matching workers to the work needed (+20%).[14]

Leveraging AI to reimagine and redesign work will also be important to improve outcomes and help free talent for more meaningful tasks. Generative AI, in particular, is said to potentially raise productivity by 1.5% per year over a decade.[15] Payments organizations should consider getting ahead of this by identifying where Generative AI can be leveraged strategically to improve work outcomes and how to better deploy and upskill their workforce.

Additionally, it will be important to bridge the gap between desired organizational outcomes and current capabilities. This will be reinforced and executed with leadership capabilities. Ninety-six percent of surveyed financial services and payments executives believe that leadership and effectiveness in a disrupted world are important to their organizations' success. However, only 26% believe their organization is very ready to demonstrate this kind of leadership today.[16] Leaders can help map and develop workers' skills in ways that positively correlate with critical outcomes for the organization. They can also support the process of co-creation in solutioning by testing, learning, and iterating as needed to improve ways of working. It will be paramount for leaders to support and help their teams become more resilient through consistent communication and transparency, sharing how decisions are made and highlighting corresponding impacts.[17]

Conclusion

The COVID-19 pandemic aftermath and recent macroeconomic events have led to a new wave of rapid changes in the payments industry. Financial institutions are at a crossroads as they assess their strategic priorities for the coming years. As table stakes, payments providers should assess their technical infrastructure, fraud mitigation strategies, and workforce management approach to help ensure they can support the trends that we anticipate will take off in the next year:

- Increase partnerships with FIs and intermediaries to develop utilities to support fraud prevention
- Push for digital identity standards
- Invest in data management and API development to enable plug-and-play connectivity to new rails
- Make changes to operations and organizational structures to emphasize upskilled support across functions (e.g., product, operations, sales)

Endnotes

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Contacts

Zachary Aron
Principal
Deloitte Consulting LLP
zaron@deloitte.com

Lauren Holohan
Principal
Deloitte Consulting LLP
lholohan@deloitte.com

Nancy Tran
Senior manager
Deloitte Consulting LLP
natran@deloitte.com

Nora Linkous
Manager
Deloitte Consulting LLP
nlinkous@deloitte.com

Natasha Pangarkar
Manager
Deloitte Consulting LLP
npangarkar@deloitte.com

Ciara O'Muircheartaigh
Senior consultant
Deloitte Consulting LLP
comuircheartaigh@deloitte.com

Contributors

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Chris Allen, Raquel Gomez-Sirera, Jacob Novich, Michelle Klar, Shalvi Saruparia, Katie Jost, Maggie Lusk

Deloitte.