WORLDLINE

# Revitalizing card issuing

## Taking a competitive stance in a changing financial landscape

White Paper

Digital Payments for a Trusted World

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# Introduction

**Is payment card issuing truly becoming a differentiating domain? Or is it just a commodity? Will consumers choose to join or leave a financial services provider based on their issuing services?**

As digitization and technology continue to change the way we interact and transact, payment expectations are changing too. Consumers expect much more from their financial service applications, which are expected to be seamlessly integrated into their every-day lives.

This multiplication of secure payment applications is putting a strain on issuers who are increasingly challenged by expensive maintenance of legacy systems trying to balance this with development and innovation initiatives, complex technology migrations and support for new payment credentials.

In this changing financial services environment, the ability of card issuers to operate cost-efficiently, adapt quickly in the market and to organize themselves around customer experience is key.

To capitalize on the revenue opportunities of the card payment industry, issuers first need to revisit their operating and business models and decide what role they aim to play in the future financial landscape. While investments needed to meet market requirements continue to increase, issuers are challenged by the fact that, above a certain threshold, it is simply too expensive to implement a solution on their own.

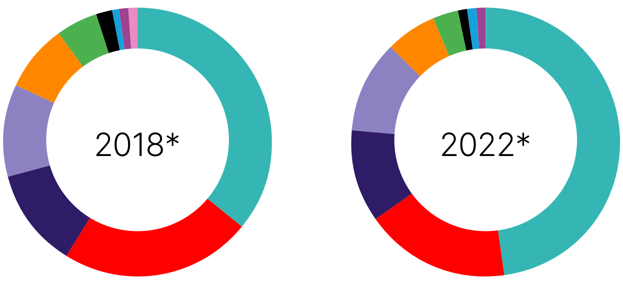
That being said, some of the largest and most well-established card issuers are (still) coping through significant in-house investments. At the same time, many of the medium and small-sized issuers are employing the modular product architectures of third-party processors as an integral part of their sourcing strategies to help them lower TCO (Total Cost of Ownership), increase efficiencies and bring innovative payment propositions to the market more quickly.

# The continued relevance of card-based payments

In a rapidly changing payments landscape, alternative payment methods are emerging to meet the expectations of consumers online. The rise and consolidation of these new payment methods alongside established payment methods like card payments are supported not only by an increase in Internet and smartphone penetration, but also by a continuous growth in retail e-commerce transaction volumes, which is expected to reach EUR 621 billion in Europe by the end of 2019[1].

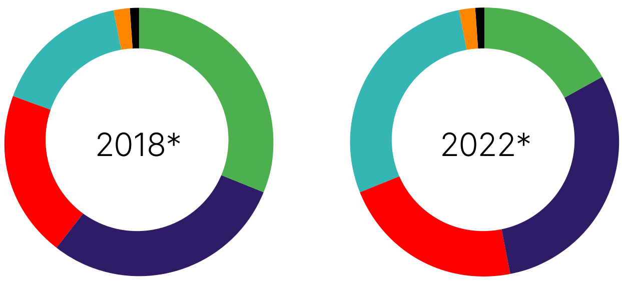
By 2022, it is estimated that 47% of global e-commerce payments will be made using eWallets, while 28% will be made using credit and debit cards. At the point of sale (POS), it is expected that more than half (52%) of all global POS payments are made using either a credit or debit card, with eWallets (28%) assuming the third place and cash (17%) dropping to fourth[2].

## Global eCom payment methods




| | 2018* | 2022* |
|---|---|---|
| eWallet | 36% | 47% |
| Credit Card | 23% | 17% |
| Debit Card | 12% | 11% |
| Bank Transfer | 11% | 11% |
| Charge & deferred Debit | 8% | 6% |
| Cash on Delivery | 5% | 3% |
| Pre-Paid Card | 2% | 1% |
| PostPay | 1% | 1% |
| eInvoices | 1% | 1% |
| PrePay | 1% | 0% |
| Other | 0% | 0% |

## Global POS payment methods




| | 2018* | 2022* |
|---|---|---|
| Cash | 31% | 17% |
| Debit Card | 29% | 30% |
| Credit Card | 20% | 22% |
| eWallet | 16% | 28% |
| Charge Card | 2% | 2% |
| Pre-Paid Card | 1% | 1% |

Source: Worldpay; Global Payments Report 2018.

1 Ecommerce News, https://ecommercenews.eu/ecommerce-in-europe-e621-billion-in-2019/
2 Payments Cards & Mobile, https://www.worldpay.com/us/insight/articles/2018-11/global-payments-report-2018

With eWallets being a digital extension of the use cases for the physical payment card, as the electronic wallet typically contains a digital representation of the physical payment card, it is clear how card-based payments are still an integral part of a larger financial ecosystem of consumers and businesses conducting their daily payment transactions. From a payer perspective, the general appeal of the payment card and card-based payments is explained by several advantages of the payment method, including the fact that it is convenient, fast, familiar, reliable, secure and omnichannel-enabled.

In recent years, account-based payment methods and the instant payments revolution have gradually begun (although in various pace) to transform the global payment landscape. From a merchant perspective, the potential upside of these payment solutions is very attractive, as they could potentially reduce transaction costs, improve liquidity and reduce the cost of handling chargebacks.

However, these solutions would require investments from the merchants and potentially many different integration points as no common standard or international scheme has been put in place for these account-based payment solutions. On top of that, there is still the issue of how to manage acceptance and create a seamless checkout flow. All of these areas have been addressed and continuously improved by the card-based payment solutions.

As a result, existing and new players across different industries continue to invest heavily in card-based payment methods, products and services. Looking a little further ahead, we are likely to see the general replacement of tangible plastic cards by alternative means of payment like mobile payment apps and virtual cards. However, the payment itself will remain card-based and will, thus, to a large extent rely on the established infrastructure of schemes like VISA, MasterCard and local schemes.

# The evolving card issuing landscape

Originally, banks became card issuers and card managers to provide their customers with a convenient way to access their bank account. But card issuing and card management was never the core business of the bank. Over the years many traditional banks have delivered card payment services on a 'license to operate' basis, meaning that they have typically issued basic products like debit, credit and prepaid cards and have not shown any interest in differentiating themselves through these products – often due to the modest business case of these products compared to 'core banking' products like lending and investments.

Along the way, the traditional banks were joined by a growing number of modern banks which embraced the options for using cards as a means to differentiate their payment products and strengthen their customer acquisition and retention through attractive or innovative card products and services. The latest addition to the card issuing landscape is represented by challenger and neobanks, e-commerce and retail merchants, telco and insurance companies as well as global technology companies.

Much like the modern banks, the neobanks have been busy bridging the gaps in the card issuing market that many traditional banks have not addressed sufficiently (so far). While refraining from disrupting the card industry completely, they are indeed revitalizing the card industry. The neobanks seem to be releasing the full potential of cards and card payment services by making them the focal point of additional services which places the cardholder at the center of the payment experience. Today, they are growing their user base by improving on traditional card products and providing the customer with high-demand features, namely real-time information on transactions, convenient onboarding processes and product control (e.g. spending limits and geo-blocking).

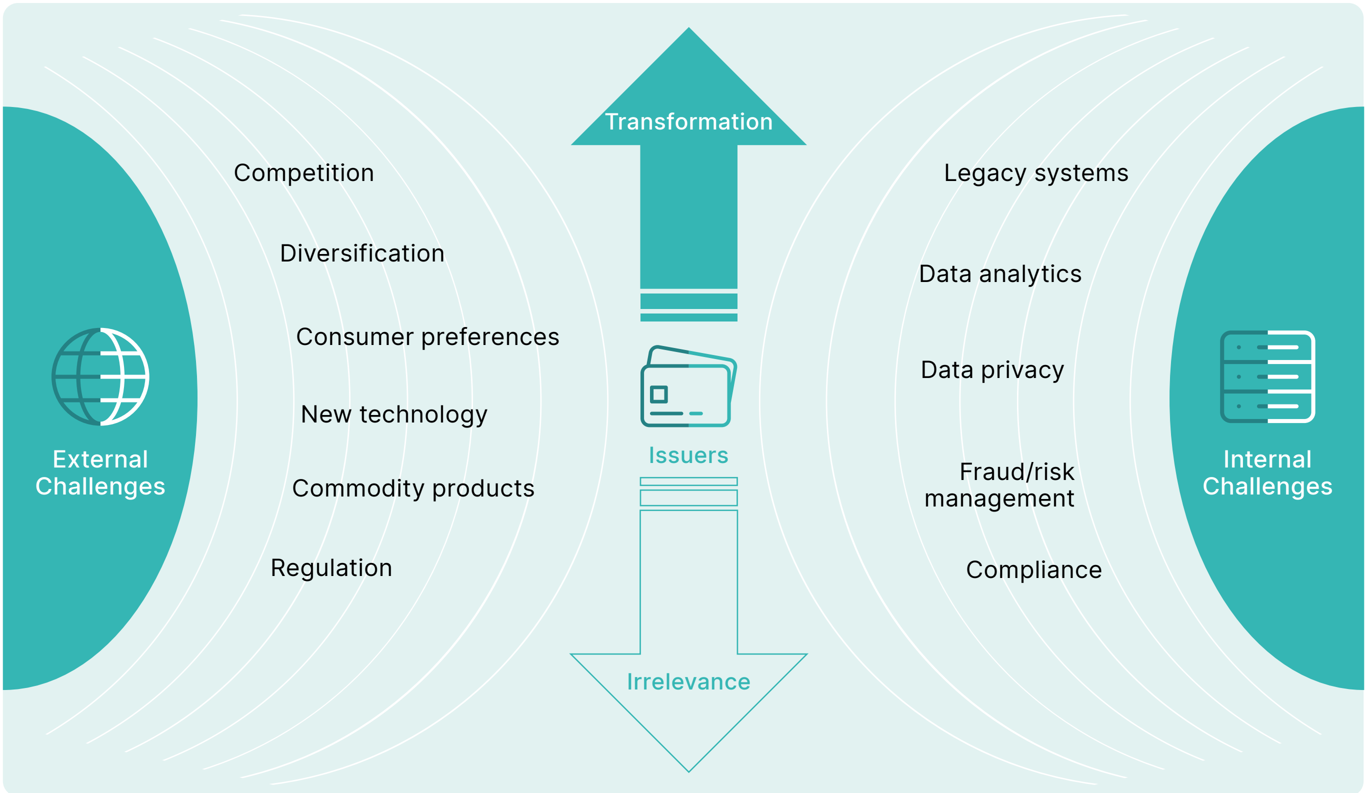
As a result, the traditional banks are feeling the pressure of the increased competition. Many traditional banks have overlooked the value in the fact that payments is the most frequently used financial service for most consumers and, as such, plays a vital role in the ongoing issuer and cardholder relationship. Should the banks lose this daily engagement with their customers, they will also lose an important foundation for selling the more traditional banking products like lending and investments.

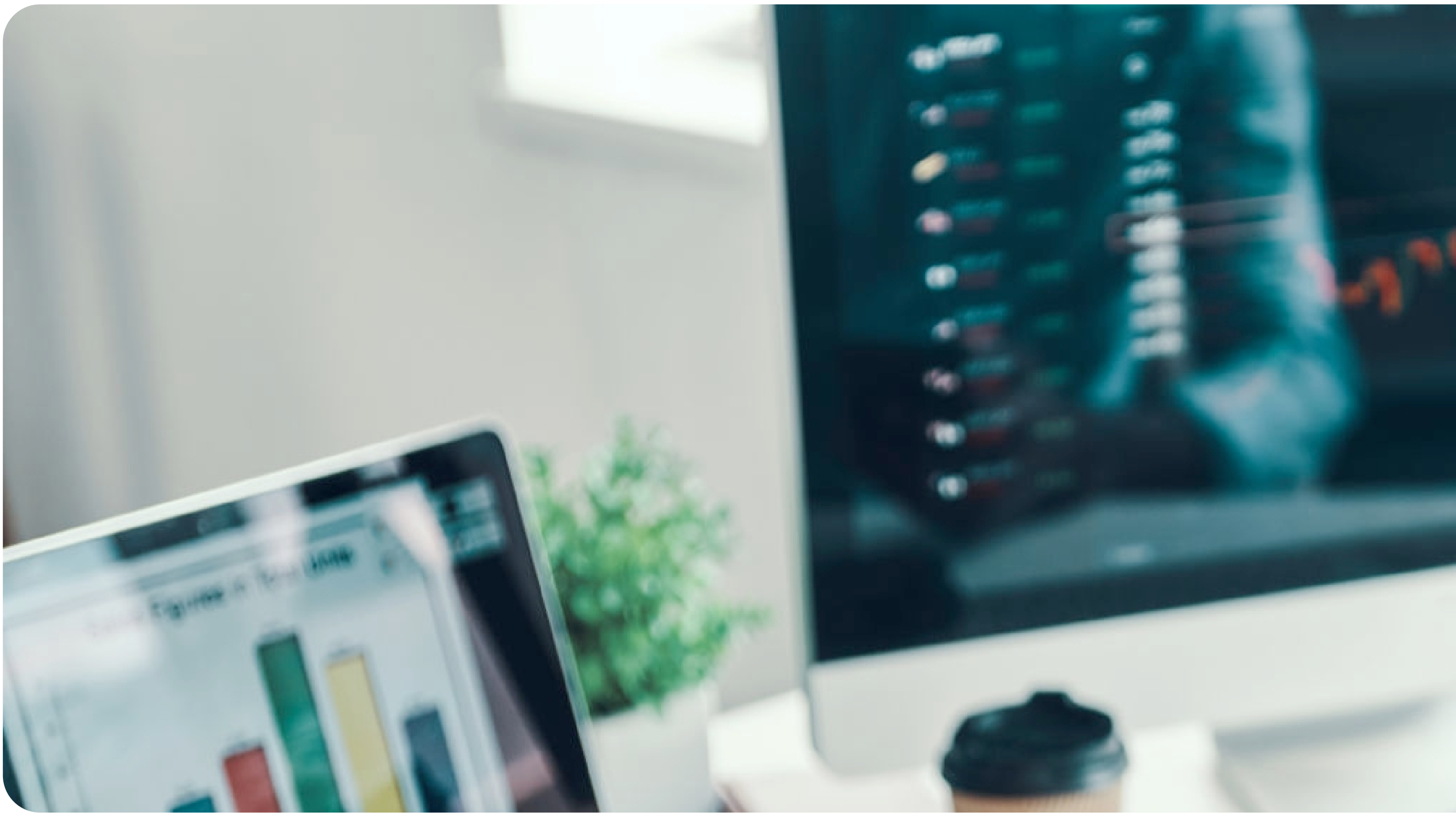
Payments as a mean of consumer interaction are also what drives the big retailers and global technology providers to embrace card issuing. These players are using card issuing to strengthen customer relations and loyalty, to improve conversion rates (e.g. by offering payment in instalments) and to reduce their interchange costs. Entering the card issuing space, these two groups of players add to the pressure on existing traditional card issuers as both groups are typically much more experienced in building and driving loyalty programs and value-added services.

# The challenges faced by card issuers today

The card issuing landscape is getting increasingly crowded as new players spot an opportunity to tap into the unresolved growth potential of the card payments industry to pursue their own objectives. This development, which urges card issuers (and traditional card issuers in particular) to transform their card processing platforms to remain competitive, is further reinforced by a number of internal and external challenges.

With increasing internal and external pressure, business as usual is not an option. In the case of the illustration below, irrelevance refers to the potential irrelevance of issuers in the eyes of the consumer/market. If the issuer does not adequately react to the challenges described below, then the consumer will simply abandon the issuer and choose a competitor who does.





## External challenges

### New entrants are increasing competition

According to Accenture Research analysis, more than 1400 new companies have entered the financial services market since 2005[3]. These new digitally fluent fintechs, challenger banks and global technology companies are leveraging technology to deliver innovative solutions to high-demanding consumers. Looking to improve the flexibility, configurability and time-to-market capabilities of their issuing platforms to remain on par with the market, many traditional card issuers are challenged by legacy systems and the fact that they are managing numerous segmented card portfolios.

### Payment channels are diversifying

The recent advancements in technology have led to the proliferation of alternative payment channels and tools, including examples like digital wallets and wearable devices. With the growing amount of available payment channels, card issuers are challenged by the expectations of demanding consumers to deliver a consistent, coherent and controllable end-user experience, both in online and offline payment environments.

### Consumer preferences are developing

With the rise of the internet and the proliferation of mobile devices, consumers – and younger generations in particular – have adapted to a new way of interacting and transacting. Today, consumers expect (card) payments to be a convenient, instantaneous, flexible, personalized and secure digital experience. In line with this development, many traditional card issuers could benefit greatly from the ability to tap into card data streams to deliver more personalized products and services to consumers and increase customer loyalty.

### New technologies are disrupting financial services

The digital era has accelerated the advancement of disruptive technologies in financial services. Presently, it is becoming increasingly clear how leveraging these technologies and technology-enabled features can help financial institutions transform their banking businesses into more efficient and customer-centric versions. In a recent report[4], Atos provides an overview of the most commonly recognized disruptive technologies with an indication of their likely business impact and integration timeline. Technologies such as APIs that can be used by financial institutions to enhance service offerings towards their customers, and Robotic Process Automation that enables financial institutions to structure and streamline an increasing amount of data, services and integrations.

### Payment processing has become a commodity

With the increased standardization and commoditization of payment processing, financial institutions are forced to focus on efficiently processing massive volumes to sustain the increasingly lower margins on payment services. This means that only very few issuers will have sufficient volumes to make the business case viable. At the same time, the increasing commoditization of issuer processing allows little room for differentiation.

### Regulation is increasing the compliance burden

Since the financial crisis, many new regulations have been passed to increase the resilience of the financial system. Financial institutions, for their part, have been forced to scale up their compliance management functions to stay ahead of legislators and avoid fines and penalties. In addition to the most widely discussed piece of regulation, PSD2, which is challenging financial institutions to provide Strong Customer Authentication (SCA), a number of additional legislative initiatives including the General Data Protection Regulation (GDPR), eIDAS regulation, the Payment Accounts Directive (PAD), the second Wire Transfer Regulation (WTR2) and the fifth Anti-Money Laundering Directive (AML5) are also affecting the card payment market.

## Internal challenges

### Legacy systems are preventing digital transformation

While 85 percent of banks in EY's 2018 Global Banking Outlook report[5] named implementation of a digital transformation program as a top business priority in 2018, the leading challenge for many traditional card issuers is still entrenched legacy systems. Known for eating up large portions of IT budgets, these complex and siloed systems are inflexible and expensive to maintain and impede the institutions' ability to scale, innovate at speed and deliver value-added features and excellent customer services to consumers.

### The inability to leverage card data analytics is becoming critical

The fact that most financial institutions struggle with intricate and rigid legacy systems makes it a lot more difficult for them to leverage the vast amount of data points produced by customer card transactions. The ability to collect and analyze card data is imperative as it can be used to better understand customer behavior, develop new customer-centric products and services, predict future payment patterns and trends, discover and fight fraud (in combination with advanced technologies like Artificial Intelligence), reduce chargebacks on the merchant side and determine how and where to make business improvements,

### Data privacy

After an increasing number of data breaches and other incidents involving misuse of personal data, data privacy is very much top of mind with consumers and regulators, as the amount of customer data produced through payments is enormous and of a very sensitive nature.

### Fraud mitigation becomes a differentiator

While protecting personal and sensitive data is becoming more important to consumers and regulators, protecting the actual monetary transactions against fraud has always been an essential part of the card business. As the sophistication of attacks is constantly increasing, security features have evolved into a competitive differentiator. As such, card issuers are expected to have risk mitigation solutions in place to protect consumers against card-not-present (CNP) fraud and counterfeit card use as well as for managing data breaches and facilitate safe and secure payment transactions.

### Compliance related cost is increasing

Financial institutions are struggling to manage and conduct the increasing number of compliance procedures being put in place. A Thomson Reuter survey (2018) estimates that 66 percent of financial services firms expect the cost of compliance staff to increase, up from 60 percent in 2017[6]. While compliance management costs continue to rise, the resources left for most card issuers to focus on new service development and innovation shrink in response.

[3] Accenture, Star Shifting: Rapid Evolution Required: https://www.accenture.com/_acnmedia/PDF-87/Accenture-Banking-Rapid-Evolution-Required.pdf
[4] Atos Thought Leadership. Look Out 2020+. Industry TrendsBuilding the intelligent business platforms of tomorrow, https://atos.net/content/mini-sites/look-out-2020/banking/
[5] EY, 2018 Global Banking Outook: https://www.ey.com/Publication/vwLUAssets/ey-global-banking-outlook-2018/$File/ey-global-banking-outlook-2018.pdf
[6] Thomson Reuters, The ninth annual Cost of Compliance survey: https://legal.thomsonreuters.com/en/insights/articles/cost-of-compliance-2018-report-your-biggest-challenges-revealed

# In search of a future-proof solution

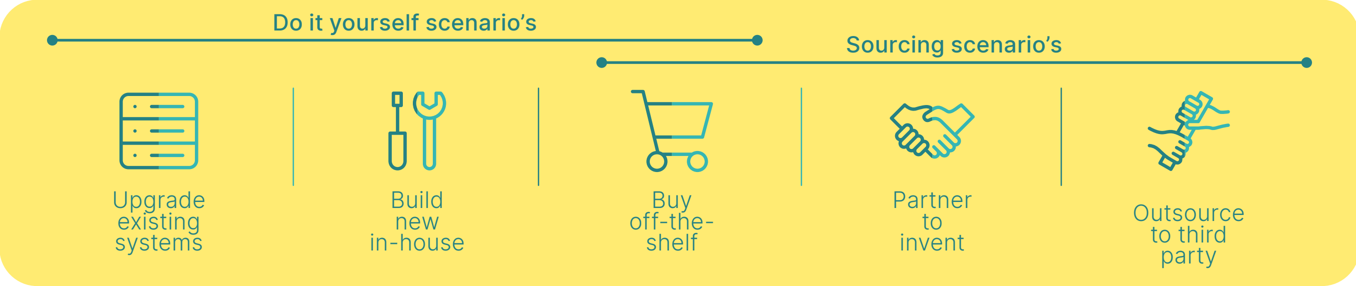
**Driven by the internal and external challenges described above, cards and card-based payments are currently transforming from a pure commodity product to being the subject of innovation and differentiation. This transformation is changing the requirements placed on traditional card issuers as well as on their card issuing platforms. In the new environment, the ability of card issuers to adapt quickly to changes in the market and to organize themselves around customer experiences is key. And for that, card issuers need a modern and standardized card processing service that:**

- improves time to market for new and innovative card products and services
- offers real-time interfaces and instant card issuing
- is capable of extracting valuable analytics from card transactions
- offers a range of plug-in value-added services on top of the card issuing processing
- is scalable for large card transaction volumes at a predictable monthly cost
- is robust, reliable and available 24/7
- is compliant with current regulatory requirements and designed to adapt easily to future requirements

In an effort to align with the requirements of an evolving industry and remain profitable and competitive, card issuers are compelled to make more explicit strategic choices as well as to adjust their operating models – including their card issuing platforms - in accordance with these choices. Clearly, updating the card processing infrastructure is an immense undertaking implicating a broad spectrum of internal operation capacities. That's why issuers are urged to reflect thoroughly on the current and future needs of their business and to consider how added functionalities will agree with existing technological, operational and strategic visions of the company.

While the legacy systems of many traditional card issuers have reached their limit regarding flexibility and speed, card issuers are faced with the question of how to proceed. Should they adopt a 'build-and-adapt' approach, buy a ready-made solution 'off-the-shelf', outsource the solution to an external party - or opt for a combination of the available options?

For new players entering into card issuing, in-house development or installation of standard products are not viable nor attractive options as these players do not see themselves as financial services providers (with all the effort that this entails). Rather, they seek ways to leverage payments to improve their existing service offerings, making payments the value-added service rather than it being the other way around. For these players, sourcing issuing as a service from a specialized provider is just the only viable option available, and the strategic choice is not about the delivery model, but rather about the strategic fit of the supplier.




## The available options

Aiming at transforming their card issuance and processing platforms to fit the payments market of the future, traditional and new players are presented with a number of different options:

### 1. Upgrading existing system

This option speaks to the traditional card issuers – primarily banks – that know what they have and like to stay in full control. The main benefits of this approach are definitely the high degree of familiarity associated with working with the same vendor and the fact that the issuer does not need to make any upfront investment in the area of new software and solutions. That being said, bearing in mind the inherent issues of running and maintaining existing legacy systems, this approach might very well turn out to be more costly in the long run. Additionally, in the process of applying additional functionalities to old systems, it might be difficult to employ the right resources for the job.

### 2. Building in-house

One primary advantage of building an in-house solution is that it enables the card issuer to remain in full control of every aspect of the development and ensure that the new system can be integrated with other adjacent in-house solutions. And issuers can use the most modern technology for this. However, building a custom card payment processing system in-house is very costly and it does not remove any of the present or future maintenance, compliance or improvement costs associated with keeping such a system running and competitive. Furthermore, the proliferation of services means that card issuers will have a hard time retaining enough people to cover all the skills needed to do everything in-house. Finally, a single card issuer on its own will not be able to achieve the scale-benefits compared to the volumes that shared solutions can generate.

### 3. Buying off-the-shelf

The benefits of buying a solution from a specialist third-party provider are significant. It will provide the card issuer with a set of standardized, ready-to-use solutions and effectively reduce the time-to-market for new products and services. At the same time, this option also allows for sharing research and development, as well as compliance costs with other users. Buying off-the-shelf products typically entails an upfront investment by means of license costs. Depending on the provider, the card issuer will see different degrees of influence on release cycles. While off-the-shelf products are standardized, most suppliers do offer bespoke additions to the standard product. Adapting standard systems is a choice that needs analysis as customization on top of a standard solution can lead to increased cost and decreased flexibility. That said – in most cases, only few card issuers decide to replace everything at once, thus, a standardized system will have to integrate to the legacy systems. As a result, it makes bespoke development difficult to avoid altogether.

### 4. Partnering to invent

Card issuers choose this approach if they feel that there is no appropriate solution available in the market. Partnering with a supplier can provide them with an agile and innovative best-of- breed system that includes scalable benefits. On the other side, partnership management is not a key competency for most card issuers and scouting for the right partner can be a time-consuming process. In addition, any invented solution will need to be tried and tested thoroughly, which is also time-consuming.

### 5. Outsourcing to third party

Choosing to outsource as an approach will help card issuers to develop a more service-oriented issuing infrastructure. It enables them to add new channels and services, phase out old core systems while supporting their overall strategies. That said, outsourcing comes with some of the same challenges as off-the-shelf products as it requires a certain degree of streamlining of current processes to fit those of the supplier (as well as other issuers on the same platform). Without a structured assessment of current systems and processes, an outsourcing exercise could easily be limited to the idiomatic "your mess for less" approach.

When properly utilized, outsourcing card processing can help issuers to streamline their business operations significantly. It can deliver a new degree of flexibility to the issuers, where they are free to pick-and-choose the new functions and services they wish to integrate into their card payments platform. In addition, transferring the card processing functions – or part of them – to a specialized third-party provider will help to minimize the complexity, costs and risks related to non-differentiating operations, as the provider will:

- handle the **regulatory burden of staying compliant**
- handle the **HR burden of retaining payments experts**
- make **costs lower**
- make **operations more efficient**

With most card issuers offering the same card payments services today, outsourcing card processing should also provide the issuer with a degree of influence on the scope and the scale of the service. In other words, it should be flexible enough to accommodate the need for an issuer to add additional functionalities targeted to a specific client base. Outsourcing card processing will enable issuers to free up resources to focus on core competencies and differentiating activities like customer relationships, advisory services, client acquisition and value-added services. In addition, outsourcing helps to enhance efficiency through consolidating and centralizing functions, share costs for compliance and research and development with other customers and ensure connectivity with all clearing and settlement networks. This is the reason why more and more card issuers are considering outsourcing as a viable strategic solution to their challenges.

It is worth noting that every card issuer considering outsourcing as an option should always begin by developing a business case to compare their current cost levels with cost levels when outsourcing. This business case should then be extended with a comparison of the features and flexibility of their current solution compared to those of the outsourced one. This way, the issuer will get a sense of the cost-saving potential as well as an assessment of the strategic fit of the outsourcing option beforehand.

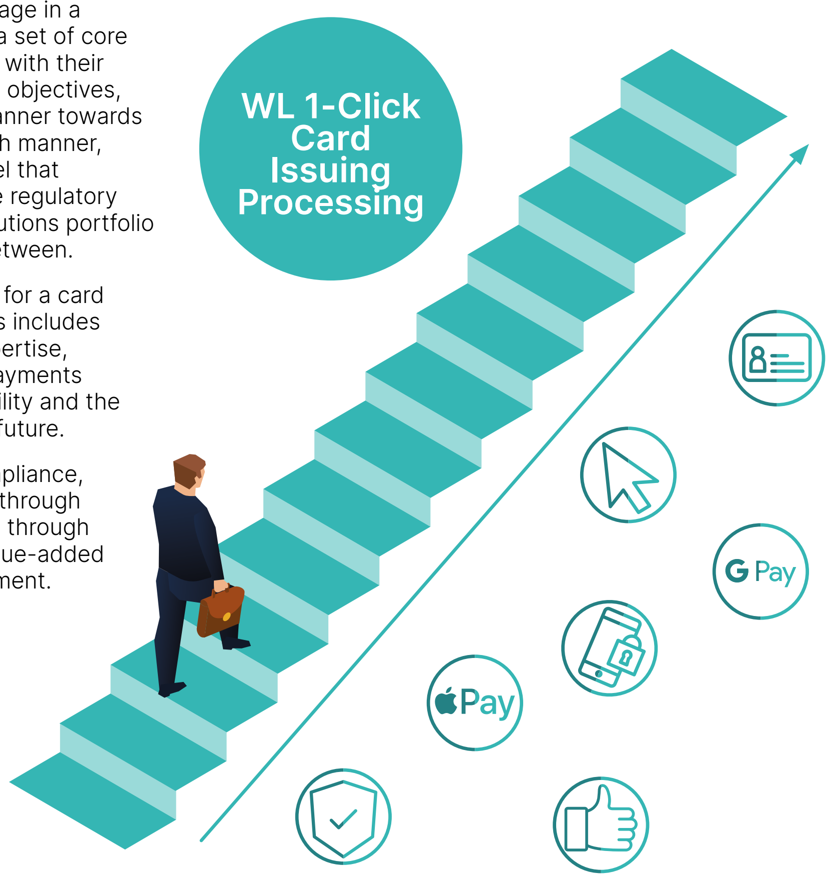
# A modular approach to outsourcing

**The outsourcing of card issuing and processing clearly comes with a set of distinct advantages, most notably the ability of the card issuer to focus on its core business by cost-efficiently leveraging the services of specialized third-party providers. However, it is also associated with the common concern of losing visibility and managerial control over systems and business processes.**

While this is certainly a valid concern and something that should be taken seriously, it is important for card issuers to realize that the best outsourcing models offered by third-party providers are based on a stepped adoption approach. In other words, card issuers can engage in a relationship with these vendors by purchasing a set of core functionalities/services and then, in agreement with their specific operational requirements and business objectives, increase this engagement in a step-by-step manner towards full business process outsourcing (BPO). In such manner, the card issuers can choose an operating model that ensures compliance with the current and future regulatory landscape, commit to a holistic end-to-end solutions portfolio – or choose a bespoke solution anywhere in-between.

Throughout this entire process, it is paramount for a card issuer to partner with a provider they trust. This includes partnering with a provider with experience, expertise, integrity and a long-term commitment to the payments industry, including demonstrated financial stability and the ability to invest in the payment platform of the future.

A strong partner can increase efficiency in compliance, lower cost and improve operational excellence through consolidation and, finally, enable differentiation through standardized interfaces to third-parties and value-added APIs for in-house product and service development.




**Value-added services step-by-step: digital journey**

Core functionalities as a starting point

## A fast and complete card-issuing package

**WL 1-Click Card Issuing Processing provides issuers with a fast and complete card-issuing package that includes, at its core, card management services, authorizations and transactions processing as well as chargeback tooling. Issuers are, at any time, able to enhance the core functionalities with additional value-added services, including our Access Control Server (ACS) for 3-D Secure transactions (PSD2 compliant and integrated with our Strong Customer Authentication (SCA) solution), full real-time and near real-time fraud detection and prevention services as well as an Issuer Token Service Provider (I-TSP) module which allow issuers to offer a complete customer journey with tokenization and provide all Xpay (Apple Pay, Google Pay, etc.).**

For more information on the details and benefits of WL 1-Click Card Issuing Processing, please see our brochureor contact us. Our experts are ready to advise you on the operating model that fulfills your needs best.

# Conclusion

**Responding to the ever-evolving consumer expectations and market requirements of the financial services industry, card issuers are forced to rethink their operating and business models in order to retain their customer relationships and remain competitive – or risk irrelevancy.**

The ideal solution is one that will help them operate reliably and cost-efficiently, adapt quickly to changes in the market and organize themselves around exceptional customer experiences.

While weighing carefully the strengths and weaknesses of the available options, many issuers are persuaded by the compelling value propositions of modular outsourcing models offered by third-party providers, which include:

- complete transparency in pricing as prices are tiered and based on volumes
- lowering TCO on non-differentiating back-end issuing functionalities through economies of scale
- offering 24/7 end-to-end real-time processing of all card payments
- managing many different types of transactional processes at high performance
- ensuring full compliance with current regulations and applicable payment schemes
- leveraging the provider's investments in state-of-the-art technologies and best of breed solutions
- improving time-to-market for new card products and services

By opting for an outsourcing solution of a specialized payment service provider, issuers are provided with an industrialized and cost-effective technical foundation, ultimately enabling them to shift their focus from non-differentiating activities to product development, innovation and value-added servicing.

# About Worldline

Worldline [Euronext: WLN] is the European leader in the payments and transactional services industry and #4 player worldwide. With its global reach and its commitment to innovation, Worldline is the technology partner of choice for merchants, banks and third-party acquirers as well as public transport operators, government agencies and industrial companies in all sectors. Powered by over 20,000 employees in more than 50 countries, Worldline provides its clients with sustainable, trusted and secure solutions across the payment value chain, fostering their business growth wherever they are. Services offered by Worldline in the areas of Merchant Services; Terminals, Solutions & Services; Financial Services and Mobility & e-Transactional Services include domestic and cross-border commercial acquiring, both in-store and online, highly-secure payment transaction processing, a broad portfolio of payment terminals as well as e-ticketing and digital services in the industrial environment. In 2020 Worldline generated a proforma revenue of 4.8 billion euros.

worldline.com

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