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"The right change, the right way, with the right people"

Why a Pan-Nordic Payment Infrastructure Could Keep Banks' Competitors at Bay

Key Perspective Takeaways

- An introduction to Project 27
- Nordics can be the first region with domestic and cross-border payments in multiple currencies
- Traditional banks need to change if they want to be a part of the future payment landscape
- P27 can be a potential boost for Nordic economies
- Collaboration is the key to success in a fast evolving environment
- Banks must meet customer expectations
- There are challenges that need to be overcome
- If successful not only will the banks be the winners, but there can be significant benefits for society, customers and industry

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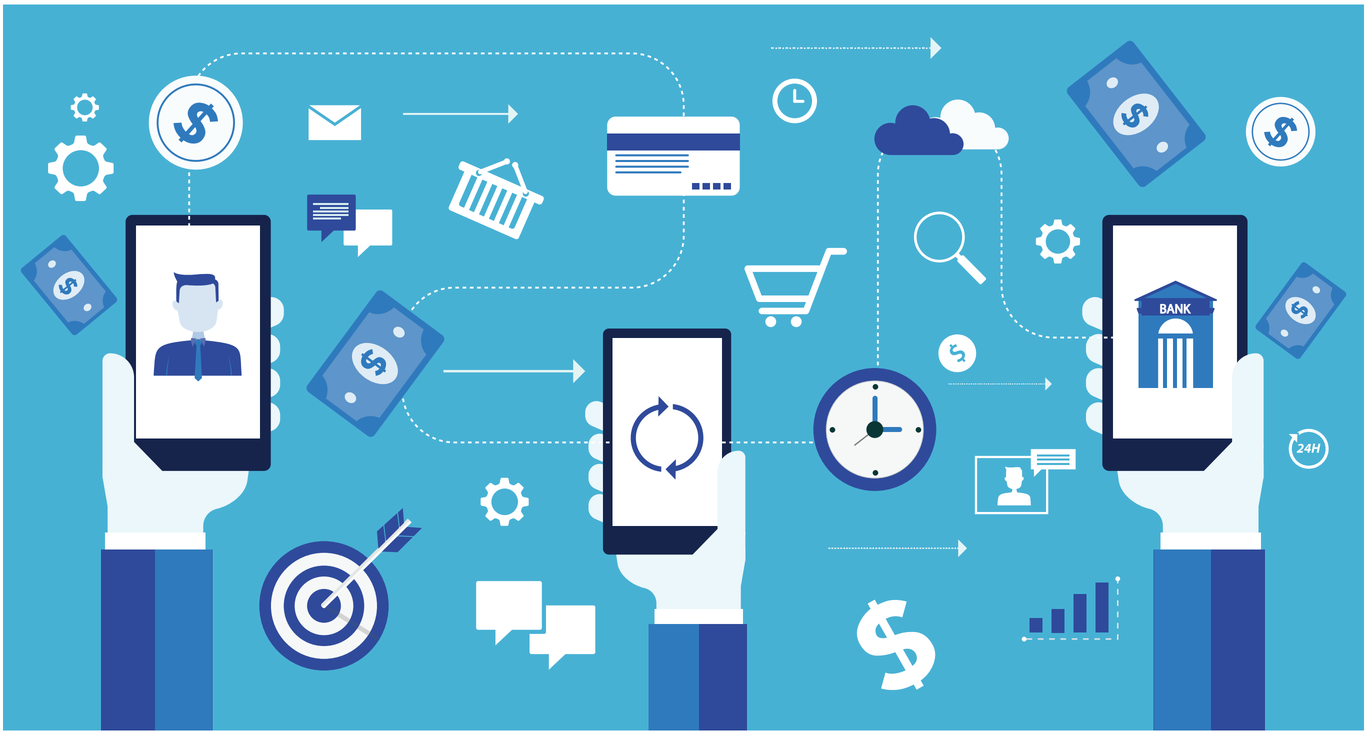

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About this article

Another first for the Nordics financial ecosystem comes in the form of a vision to become the worlds' first region with domestic and cross-border payments in multiple currencies. But will it be enough to strengthen banks' positions and hold on to valuable market share?

Project 27 is still in early phase but the possibilities, as well as the many challenges, are all interesting aspects to address. Is this the change needed for the banks' in a fast-evolving environment or should their focus be elsewhere? The purpose of this 421 perspective is to shed a light on both sides of the coin.

Project 27 Is Born

Via a joint press release at the beginning of February 2018, seven major Nordics banks revealed that they are behind a unique initiative to explore the creation of a pan-Nordic ISO 200022-enabled payment infrastructure.

Those behind the initiative – collectively named Project 27 (P27) in reference to the 27 million residents in the Nordic countries – are Danske Bank, DNB, Handelsbanken, Nordea, OP Financial Group, SEB and Swedbank. P27 is still in the planning phase but expectations are high.

Cross-Border Payments Will Encourage Collaboration

Collaboration between the Nordic countries would further exceed and benefit corporates in the region with the help of cross-border payments which should ease trade as well as stimulate growth and employment[1]. The right platform would not only enable payments in multiple currencies, it would do so also having the potential to enable instant pan-Nordic payments.

First Transaction in 2020?

The technology supplier for the payment platform is as yet unknown. Sweden's Bankgirot, (provider of clearing and settlement and the payment system Payments in Real time) and Finland's IT software and service company Tieto have both expressed an interest in the possibilities that a project of this magnitude could generate, but neither has announced any official involvement. According to the P27 website, a contract with final vendor should be signed in Q1 2019 at the latest. This goal is ambitious even though the milestones have been adjusted. The plan is to make the **first transaction in 2020.**

Even though the central banks stand behind it and relevant authorities appear to be onboard, there are still obstacles to conquer and a decision will be made by the P27 CEOs at the beginning of 2019[2].

Drivers of Change

When tech giants Apple, Amazon and Samsung are knocking at the door, is this the necessary step to staying ahead when it comes to offering payment solutions for the Nordic public? And, it's not only tech companies who want a piece of the cake – new fintech companies are aiming high when it comes to market shares in both

1 https://tinyurl.com/y832ndgw
2 https://tinyurl.com/y9vgdzph

smart payment solutions, consumer loans and mortgages.

The answer is clear: Traditional banks must respond to the drivers of change in the financial market, but at what cost?

Niklas Arvidsson[3], Associate Professor at Royal Institute of Technology (KTH) in Stockholm, has addressed the proposed future payment system. He believes that while development is happening at an extremely high pace, competition is simultaneously getting tougher with new fintech companies that create smart payment solutions that are more user-friendly compared to those offered by the large banks. He says that "**the traditional banks are in for a challenge and that they must be a part of any future payment landscape by offering smart payment solutions and services. Otherwise, they could be relegated to roles of mere providers of bank accounts and systems".**

Digitalisation Is Not a Choice

Transformation is necessary to be able to move forward and adapt to the rise of new technologies. Growing pressure from fintech companies is forcing banks to improve their products and services with a faster time-to-market. Many of today's banks are sitting on complex IT infrastructure built up over the years, making it more difficult to merge with new technology. They must also improve their data handling and reduce costs to stay competitive. These were all significant parameters explored during the October 2018 webinar, *Evolution in Cross-Border Payments*, hosted by SWIFT and HSBC[4].

Strategically, there is little doubt that plenty of opportunities could arise with this change, especially when we consider not only erasing borders with payments in multiple currencies, but also the capabilities of the banks involved.

A Boost for Nordic Economies

A pan-Nordic payment infrastructure could have a positive impact on Nordic online retailers, small businesses and large corporations within e-commerce. This can happen as long as P27 sticks to using only one payment platform for all Nordic countries, instead of setting up accounts with all the respective banks. One such candidate is the Swedish mobile payment system Swish.

Will it be possible to say that one of the Nordics countries will be the biggest benefactor in this endeavour? Looking at statistics presented by Swedish and Danish postal service PostNord, Nordic e-commerce grew by 11% during the first half of 2018. E-commerce is big business in the Nordics and purchases worth 10 billion euros were made by the region's consumers, where Sweden is the largest country with 4.12 billion euros, followed by Denmark with 2.49 billion, Norway with 2.24 billion, and Finland with 1.22[5].

Interestingly, Nordic consumers primarily shop online from companies in China, Germany and the UK, meaning that consumers that shop online from other Nordic countries are far fewer in number. Regardless, Nordic retail companies still see a significant growth thanks to the population's high level of e-commerce maturity, among other factors. Sweden is the main benefactor of this, which should not come as little surprise.

Another area with room for improvement is the Swedish krona. From a consumer perspective, the numbers indicate that Swedish e-commerce companies could have more to gain in volume,

3 https://tinyurl.com/ycd8q5lc
4 https://tinyurl.com/ybgvtxgq
5 https://tinyurl.com/yaxh8xuw

but Nordic e-commerce companies should also benefit from the P27 initiative. There is demand for lower prices when making cross-border payments and this is something that they want to address to benefit corporates and consumers[6].

Great Customer Expectations

Corporates are seeking and expecting the same kind of service for cross-border payments as for domestic payments where transactions taking more than a couple of hours now must be seen as taking forever and a day[7]. Real-time payments are here, and we must assume that P27 includes instant pan-Nordic payments among their priorities as they strive for the same lead times as for domestic payments. Lead time is not the only aspect customers have high expectations of, as transaction costs are also a barrier when it comes to cross-border payments today. Here, P27 sees a way where they can not only shorten lead time, but also reduce fees through more efficient clearing of payments by harmonisation and standardisation[8].

Managing Regulation

How will P27 manage differences when it comes to local regulations, new requirements and the high costs associated with these kinds of implementations? This should go hand in hand with process alignment to secure better quality when it comes to following and implementing new regulations. PSD2 is just around the corner and is certainly a part of the puzzle when it comes to the design of the technical platform.

The P27 has made it clear that the project will make it easier for banks to adapt to upcoming regulation and with that also reduce implementation costs[9].

The Importance of Synergy

Looking at drivers of change from the large banks point of view, when it comes to payment solutions and what kind of infrastructure to invest in there is more to it than the possible competition from tech giants and upcoming fintech companies.

System legacy is a well-known obstacle to change in a quickly evolving and adopting environment and that is why we have already seen banks starting to collaborate with smart fintech companies instead of trying to compete in areas where they know it takes substantial resources. One example of this type of collaboration is between SEB and Tink, where the bank can use the fintech's solution to better visualize their customers expenses in different categories. Will it be possible to integrate existing IT-platforms and payment solutions, or will this be a stand-alone infrastructure that is more adoptable to change and fit neatly into the new digitalized environment of which we are all a part? Synergy is an important factor to take into account when considering a pan-Nordic payment infrastructure that could reduce costs by sharing a common platform. It is too early to say what impact it will have on the balance sheet, but system management costs could be reduced, and the banks involved would not have the need for the same amount of workforce maintaining daily operations.

What Else Is Out There?

The Nordic countries are not alone when it comes to wanting to make cross-border payments more efficient. The global payment innovation (gpi) from SWIFT has been adopted by more than 295 banks around the globe. SWIFT gpi is designed to enable better tracking of real-time

6 https://tinyurl.com/y7v977aq
7 https://tinyurl.com/ybgvtxgq
8 https://tinyurl.com/yccnohbu
9 https://tinyurl.com/y832ndgw

payments and transparency of bank fees and foreign exchange rates. So far, five of the P27 banks have gone live with it after realising how it can improve the customer experience. Rather than competing with the P27 solution, SWIFT gpi signals a move towards answering evolving market demands.

SEPA Instant Credit Transfer (SCT Inst), on the other hand, is already on its way when it comes to cross-border instant payments. SCT Inst went live in November 2017 and quickly attracted nearly 600 payment service providers across Europe making instant euro payments. By adopting the ISO 20022 messaging standard, SCT Inst enables its users to transfer up to 15,000 euros between accounts in Europe with a maximum time allowed of 10 seconds. That said, there is still a far way to go before this will reach out to all 34 SEPA countries[10].

P27 is said to be compatible with SCT Inst[11], so lessons could be learned here, and synergies could be generated – as well leading the Nordic project one step closer to a solution stretching beyond Scandinavia. For example, Nordea has already introduced instant euro payments in Finland.

Make the Right Change

Cross-border payments in multiple currencies seems like the way to go, and it would solve the demand for today, but should we hold off on preparing for eCurrencies? They might still feel far off but in fact Sweden's central bank, Riksbank, is investigating the possible implementation of an e-krona.

P27 is an initiative of massive scale as it involves seven banks from four countries with different local authorities that significantly increase complexity. We must take multiple dependencies into consideration here which also include different legacy infrastructures, design and operational constraints. These are some of the challenges for instant payments that SWIFT already been addressing[12]. It is understandable that large IT projects go over time and generate higher-than-expected costs.

While P27 is a cost-plus corporation, banks will compete for the services and propositions stemming from the initiative[13]. The only certainty at this stage is that the supplier of the payment platform will make a profit.

It is easy to focus on all the challenges that the banks need to overcome but, in this case, maybe there is more to it when talking about the right change. A multi-currency payment infrastructure could be the beginning of something remarkable here in the Nordics, and, if it succeeds, it could lead to the development of common infrastructure for direct debits and e-invoicing. Further collaboration between the Nordic countries is on the horizon, according to panellists at Finextra's NextGen Banking Nordics annual conference in Stockholm[14]held in November 2018.

Do It the Right Way

We cannot ignore how strong the large Nordic banks already are and should consider both how they will use their position and also which consequences it will have on the other players that are not part of the collaboration.

In theory, no-one will be excluded, but banks may need to make substantial changes to their

10 https://tinyurl.com/y8xje4bv
11 https://tinyurl.com/y88azogd
12 https://tinyurl.com/yd99jhcz
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technology setups to be able to participate and this will involve their customers, according to Henrik Bergman, Deputy Director for Financial Infrastructure at the Swedish Bankers' Association. The banks that are not involved don't have much detailed information regarding the new infrastructure at this stage, other than the information given to them by the Swedish Bankers' Association and what is published on the P27 website. Right now, it's hard to say if they have a structure that's easy adaptable or one that's problematic when it comes to adopting to something totally, new says Bergman[15].

Will it be possible to compete with a service like Swish working as a payment solution for all Nordic countries? It is too early to say either way, but it would definitely make it tougher for new entrants to compete with such an established solution backed up by major banks. With what can be described as a possible monopoly on infrastructure, one cannot rule out that this could lead to negative bearings for retailers and consumers in the long run if there is no competition, according to Bengt Nilervall, Head of Payment Systems at the Swedish Trade Association. He has pointed out that the Swedish Trade Association has shared its opinion surrounding Visa and MasterCard and their dominant market positions when it comes to card payments as a reference to a thinkable outcome[16].

This infrastructure could also be part of a strategy for how the banks further can aim for a more cashless society and by doing so cut expenses associated with cash management Such transformation is already taking place in the region and Sweden is leading the field. If currency becomes less of an issue, so will the need for cash when all you need is a mobile device to make a payment anywhere in the Nordics[17].

Ending On a Positive Note

P27 is definitely a move in the right direction if Nordic banks want to stay one step ahead when it comes to payment solutions and keeping customers in their grip – away from both tech giants and new fintech companies. In addition, using the synergy that collaboration can bring seems like a better way of adopting to new regulations.

If they can fulfil their high ambitions, the banks will not be the only winners. Increased trade, instant cross-border payments, better user experiences, cost efficiency and faster responsiveness will also generate significant benefits for society, customers and industry.

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