If nonbanks drive payment innovation, will banks pay for the risk management?

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Nonbanks are driving significant investment in the retail payments space today, a healthy signal to the economy that contrasts starkly to some other economic sectors, and a sign that innovation in payments businesses and technologies is alive and well. This continuing and dynamic evolution is changing the retail payments landscape in new and unexpected ways, such that all industry stakeholders will need to consider risk issues in a new light as well.

What does this spell for the role of financial institutions as retail payments service providers going forward? More importantly, how will industry stakeholders ensure integrity in retail payments systems more generally?

Venture capital and M&A activity for nonbanks
The venture capital community has demonstrated a continued interest in payment technology start-up companies, particularly in the mobile information technology market. Investment banking firm Updata Advisors recently published research reporting that out of the 16 deals the firm tracked in the third quarter of 2009 in the financial technology sector, six fell into the payments subsector. Updata also reports that it believes that new payment technology providers "with their roots in social networking technology will be prime candidates for future acquisitions by larger merchants that do not want to spend on their own R&D."

The migration from traditional to smart phones is helping drive these trends, with a number of venture capital funds investing in start-ups involved in developing smart phone applications (apps). Consider the $150 million BlackberryPartners Fund launched in 2008 by RIM, RBS, and Thomson Reuters to focus on mobile phone apps and services. Mpower Mobile, a firm that provides person-to-person (P2P) services and remittances, recently announced it had received a second round of investment to fund further technology developments such as debit and credit card functionality for mobile phones.

On the M&A front, Mint, a two-year-old, privately held personal finance service, agreed to be acquired by Intuit for $170 million in September 2009. Mint derived its revenue by directing subscribers to online financial products and services from participating institutions. Just this week, American Express announced it would acquire Revolution Money, a recently established alternative payment network, for $300 million.

Economic volatility may hinder banks' investment in payment technology
While tech firm investment in alternative payments is active and highly publicized, the same cannot be said of the banking sector. Established banks saddled with legacy payment system investments have had to balance new technology investment with existing costs while competing with de novo financial institutions.
While new bank charters flourished at the economic peak years of 2005 and 2006, the following years witnessed the largest rash of bank failures in decades. According to the FDIC report of failed banks, more than 100 institutions have been closed in 2009 alone. The turmoil in the financial services sector suggests that prospects for significant bank investments in payment-related technology may be hindered for some time. This effect was described with regard to payments risk management investments in an earlier Portals and Rails post.

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**Will risk controls take a back seat to innovation?**

The take-away from these environmentals is that nonbanks continue to drive technology investment opportunities, which in turn lead to the development of alternative forms of retail payments. The current economic environment may impede participation on behalf of the banking industry, where risk management and regulatory compliance are much more commonplace.

Within the telecom industry, by contrast, there are consortia worldwide discussing how to manage risk in mobile payments in a cross-border environment as bank-agnostic start-up firms provide new mobile remittance and money transfer services. If financial institutions are not part of that conversation on the front end, how will they address risk management and compliance issues with security and identity theft or money laundering? How will the solutions that arise from discussions on risk outside of financial institutions be implemented in a banking environment, and who will assume that responsibility?

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