EMBEDDED FINANCE TRACKER®

SEPTEMBER 2022

FEATURE STORY

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ACKNOWLEDGMENT

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Reshaping Consumer Finance Through **Digital Transformation**

EMBEDDED FINANCE TRACKER®

How consumers conduct their financial affairs is profoundly changing. In recent years, both companies and individual consumers have been gradually abandoning traditional services and physical solutions in favor of the online equivalents offered by FinTechs and other tech-forward financial institutions (FIs). When the pandemic hit, this digital shift accelerated, as health restrictions forced even the most reluctant consumers to use new technologies. As a result, digital solutions are now ubiquitous, with payments being one of the most important use cases. Most consumers are now interested in making payments across digital channels, and the use of digital wallets has increased. The same holds true for businesses, with companies utilizing digital channels like never before.

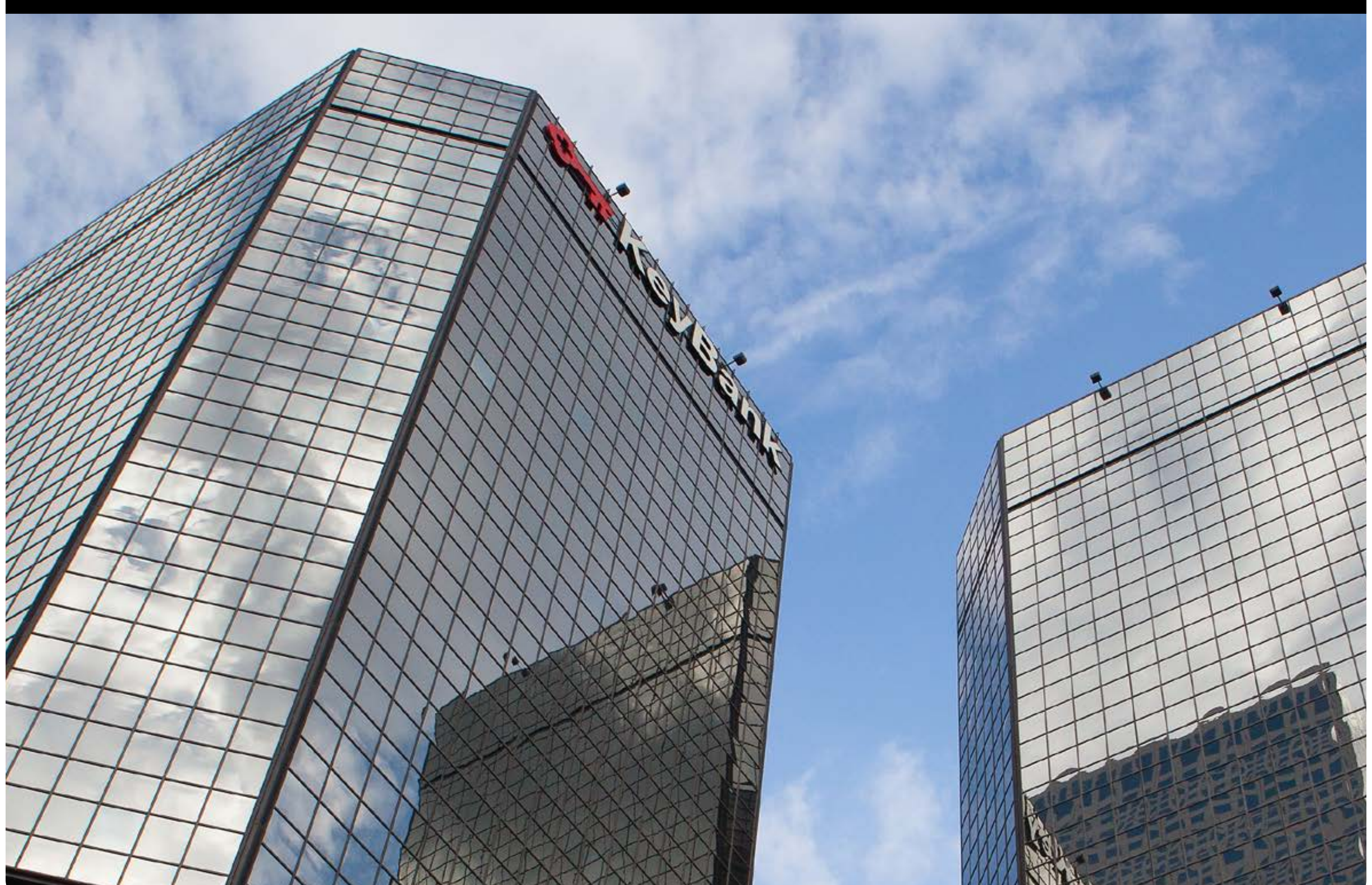
Even when the pandemic subsides, the newfound importance of digital solutions will remain. Most consumers and companies have discovered that these new products are superior to the solutions they replaced. For example, PYMNTS' data shows that 78% of Americans currently prefer to bank digitally. Another study found that 66% of consumers now believe FinTech solutions are necessary in personal finance. Companies are also eagerly adopting digital banking and financial tools. According to one study, 68% of small to mid-sized businesses (SMBs) are seeking to digitally manage as many aspects of their businesses as possible.

In this digital-first context, embedded finance is essential. It involves incorporating specific financial services — from payments functionality to cash management solutions — into other, typically nonbank products or software. Ridesharing apps are a prime example, as users can seamlessly hail and pay for a ride from the app itself. Since it can be difficult for companies to meet the rising need for digital payment solutions, let alone all the other use cases, embedded finance solutions can help. In many ways, embedded finance is the secret engine powering the financial industry's digital transformation.

This edition of the Embedded Finance Tracker®, a PYMNTS and Galileo collaboration, examines consumers' and companies' expectations around digital payments and how FIs can meet these expectations by leveraging embedded finance.

■ Feature Story

KeyBank On Why The Future Is Already Here With Embedded Banking



IN TODAY'S DIGITAL-FIRST LANDSCAPE, CONSUMERS ARE INCREASINGLY TURNING FIRST TO DIGITAL PAYMENT CHANNELS TO PURCHASE THE GOODS AND SERVICES THEY WANT.

The appeal of these channels is largely tied to convenience, as many consumers find it quicker and easier to pay digitally than with traditional, physically based payment methods. Despite the convenience of digital payments, consumers frequently face barriers to transacting digitally.

"Consumers face several challenges in making consistent digital payments," Bennie Pennington, vice president of embedded banking and integrated payments at KeyBank, told PYMNTS in a recent interview.

He identified three primary challenges consumers face when trying to make digital payments. These include merchants' lack of adoption of the latest digital payment acceptance tools, such as contactless functionality, as well as a lack of support for consumers' preferred payment methods. Finally, the continued rise in the number — and scope — of data breaches and fraud reflects the difficulties consumers face in keeping their sensitive payment credentials safe and secure at the places where they shop.

Pennington explained how embedded banking effectively addresses each of these challenges and how KeyBank is leveraging embedded solutions for its customers.

HOW EMBEDDED BANKING FITS INTO THE EQUATION

Embedded banking allows businesses to offer integrated payment and reconciliation services as part of their main software platforms, thereby streamlining day-to-day business operations. When implemented correctly, it allows companies to offer more cohesive end-to-end services to their customers. For consumers, embedded banking means offering them the latest digital access to their payment cards and credentials, as well as instant ways to track balances and transaction histories.

"Embedded banking means leveraging technology and partnering with software companies that facilitate innovation to power smoother, more integrated payment services for businesses and consumers," Pennington said.

TOP FIVE EMBEDDED BANKING USE CASES

Though there are myriad use cases for embedded banking, Pennington identified the five most important, all of which KeyBank currently offers or will offer soon.

Offering businesses solutions they need to accept any type of digital or analog payment. These could be payment gateways, electronic invoicing and payment, lockbox services, treasury management systems or anything in between.

Enabling software companies to become payment companies. Embedded banking gives software companies the merchant payment gateways, onboarding tools and risk management tools necessary for them to grow into independent software vendors or payment facilitators to better serve their clients.

Offering digital integration of accounts receivable and accounts payable technology. This could consist of payment application programming interfaces (APIs) that businesses can code for payment initiation or to get an intraday balance update. Alternatively, it could be a plugin that allows businesses to send and reconcile payments from within their accounting and enterprise resource planning systems.

Providing digital ledgering services. This allows businesses to have multiple settlement accounts for various entities within their operations, all tied to a single demand deposit account, which simplifies the managing of overall cash position and provides better visibility and control through granular reporting — all delivered via digital tools.

Providing digital disbursement solutions. This allows a client to push money out to businesses or consumers via virtual cards, back to a debit card or even to a peer-to-peer wallet.

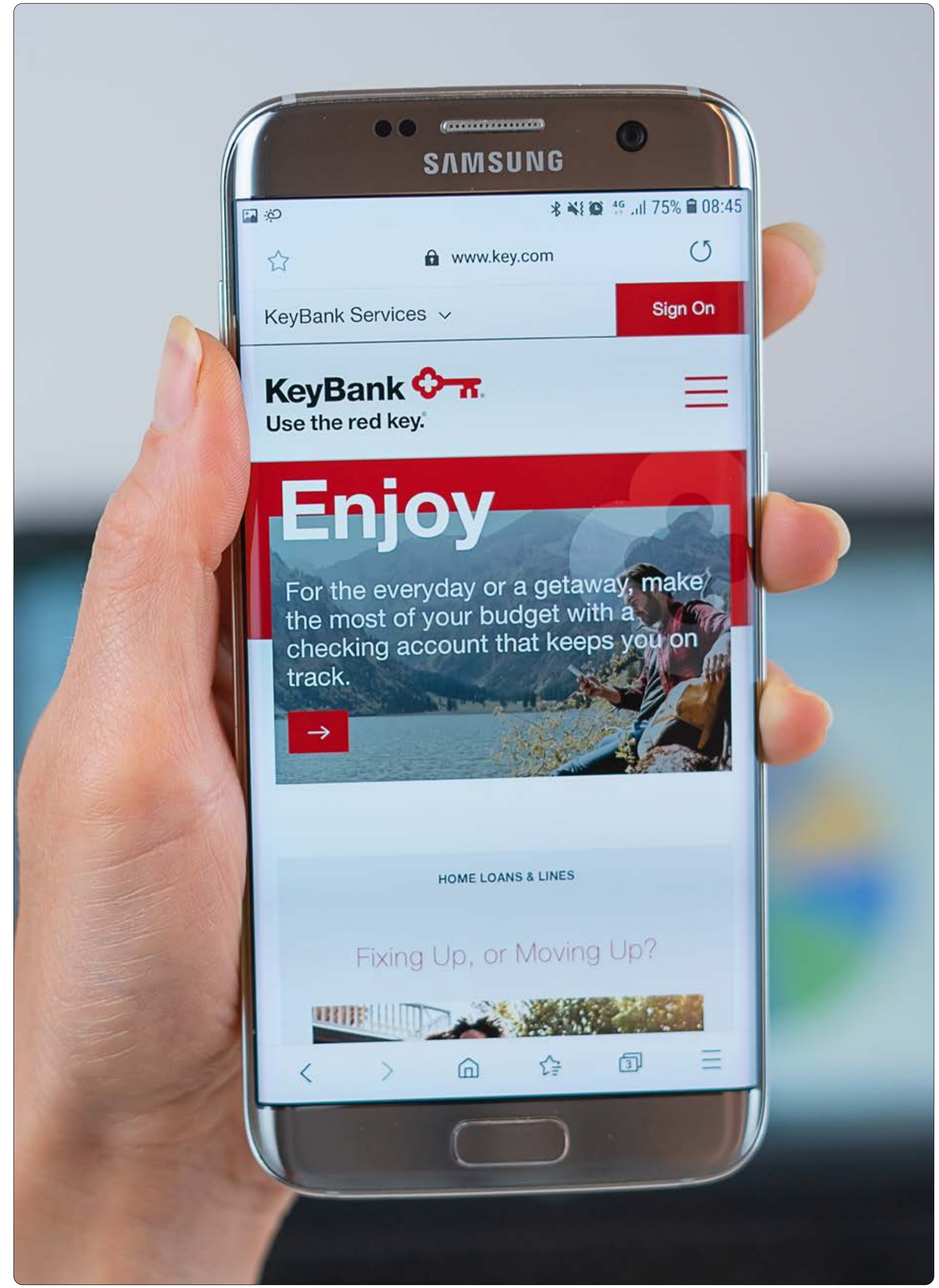
EMBEDDED BANKING IS NOT THE FUTURE OF BANKING: IT IS THE PRESENT

When asked about how important embedded banking will be in the future of banking, Pennington stressed that the question fundamentally misses the current state of the banking industry.

"Embedded banking is not the future of the banking industry: It's [already] here," he noted.

He explained that KeyBank currently wants the businesses and consumers it works with to be able to take their banking and payment capabilities with them, not just on mobile devices but also on any third-party software or tools that they regularly access. The goal is to make payments as convenient, secure and flexible as possible.

"The future is about seeing how many new use cases, industries and payment channels that digital payments can be applied to," said Pennington.



Q&A

TRISH COX
Head of operations
GALILEO

Consumers and companies are both using digital solutions more than ever to handle their financial needs. Why is that?

On the consumer side, the past decade or so has been a time of massive expansion in the availability and adoption of digital financial solutions, driven mainly by the growing ubiquity of smartphones over that period. There's a very clear value proposition in delivering services like banking, payments, peer-to-peer money transfer and stock trading via the device upon which consumers conduct so many other aspects of their lives — and is almost always within reach. These offerings have become ever more powerful and robust, fulfilling a growing range and depth of consumers' financial needs. And they're often doing so better than traditional services: For instance, we've done research that shows digital banking providers generate significantly higher customer satisfaction ratings than traditional banks.

As powerful and convenient digital financial services have proliferated on the consumer side over the past several years, we're now seeing increased demand for equally robust and user-friendly offerings on the business side — especially in the small and midsize segment, which has traditionally been underserved by financial services compared to the large corporate and enterprise segment. Many business owners and decision-makers are now expecting the same convenience and great user experiences they're used to from consumer financial services to be available in the context of their business-related financial services. And providers increasingly are listening, recognizing the market opportunity and ramping up their offerings to meet that demand.

On both the consumer and business sides, the steady rise of digital financial services was further accelerated by the COVID-19 pandemic, which shifted even more financial activity and behaviors into the digital sphere for both consumers and businesses. Even as the pandemic fades, much of that shift to digital will become permanent.

When it comes to payments, do businesses and individual consumers have different expectations and needs? How so?

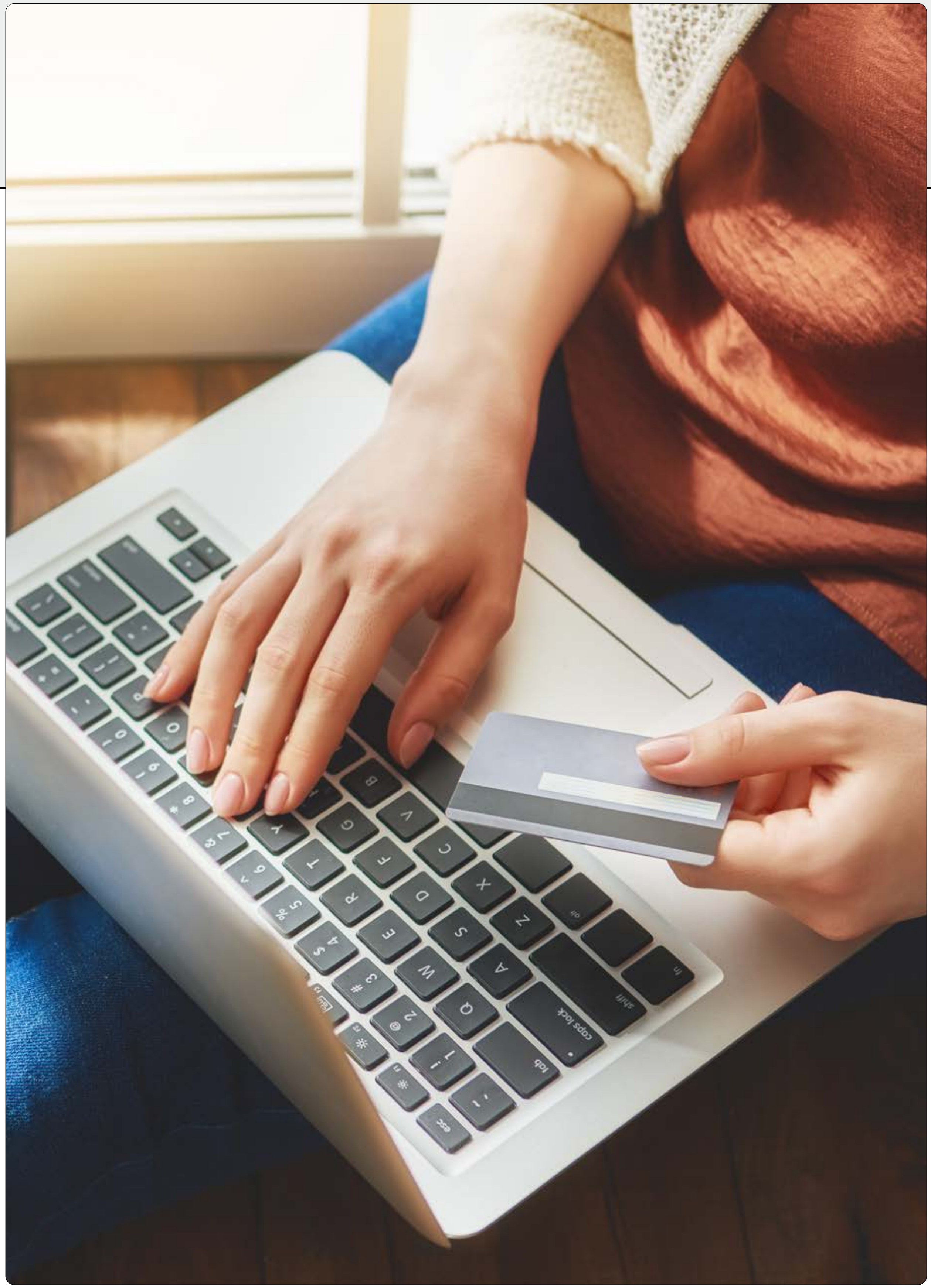
Business owners have all the same needs that consumers do for convenient and secure payments — plus the additional requirement for solutions that are cost-effective, make sense from a return-on-investment standpoint and can actually help their company's finances and operations.

Business payments traditionally have been very clunky, slow and inflexible, and those inefficient payment processes can actually impose significant costs on a company — both financially and in terms of wasted time and human capital. So streamlining and optimizing payments can have a really positive impact on a business' bottom line — and that's more important now than ever, amid the economic turmoil that's affecting a lot of companies. Faced with significant challenges like supply chain disruption and inflation, companies increasingly are looking to optimize payments to lower costs, improve cash flow and gain actionable insights and data from spending — and many are turning to digital payment tools to accomplish these goals.

Virtual payment cards are a great example of this. Virtual cards act just like traditional plastic credit cards but exist only in digital format: There's no physical card. Businesses can leverage virtual cards to make supplier payments more cost-effectively than traditional methods like paper checks or ACH transfers. That's because they're cheaper and faster to issue, require less manual processing and offer spending controls that enhance security and mitigate fraud, which can be costly.

Virtual cards can also be used to fund employee T&E expenses as an alternative to a traditional physical corporate card. For example, an employer can issue a virtual card directly to an employee's mobile wallet ahead of a business trip and can set spending limits to ensure the card can only be used to make approved purchases, such as for meals and taxis, and will only work for the duration of the trip. That way, even if the card number is later compromised by a data breach, it will be useless to fraudsters, thereby saving the company the cost — in both money and time — of having to deal with fraud losses after the fact.

Q&A



How can embedded finance meet people's digital expectations?

By enabling end users — whether consumers or businesses — to access the financial services they need within the context of the platforms and services they're already using, in a way that's relevant, seamless and convenient. If you can do that, you can eliminate a lot of the friction points that have long been associated with traditional financial products.

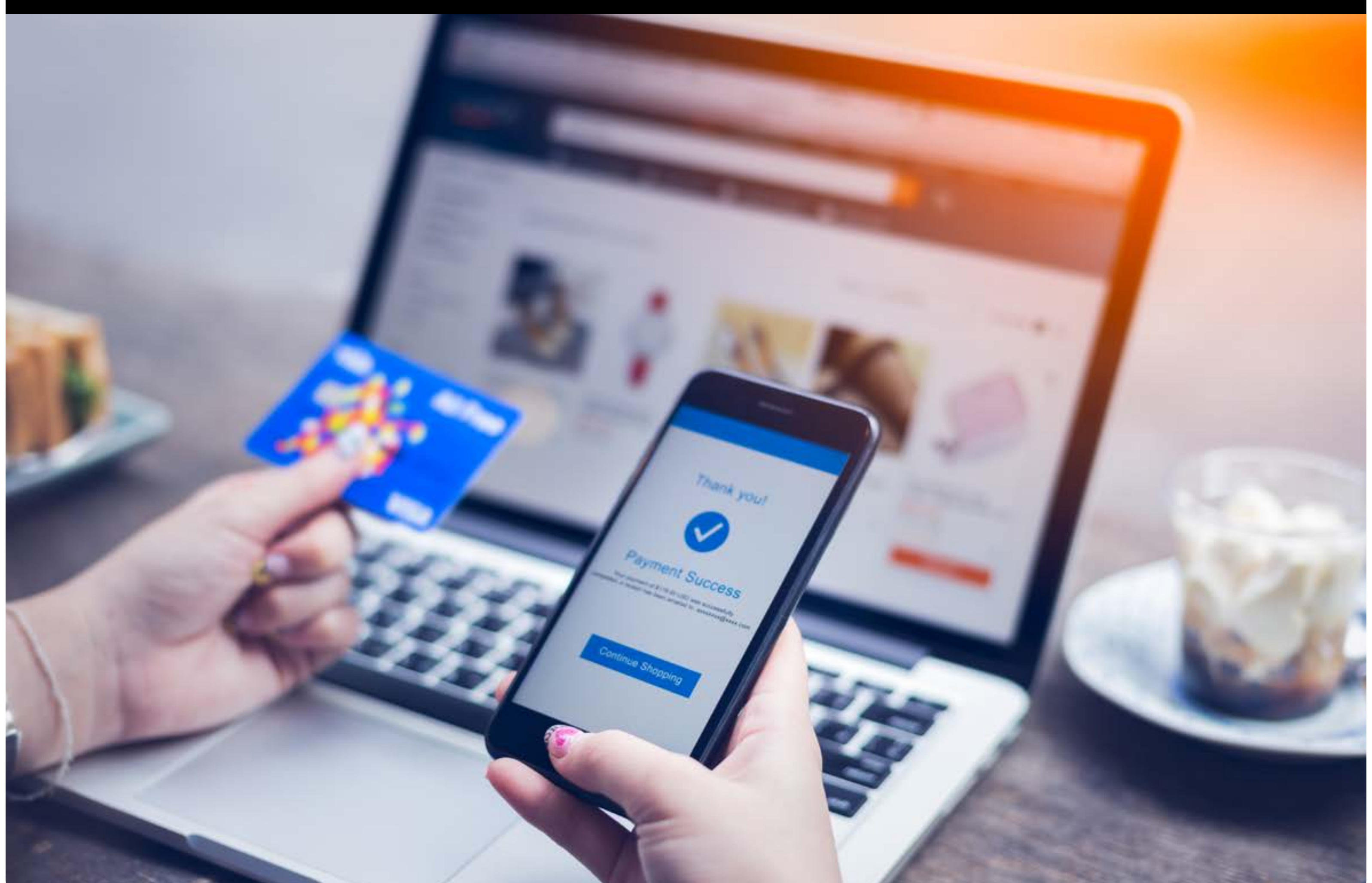
On the consumer side, that might mean enabling a shopper to access credit or insurance offerings during the course of the purchase process, without ever leaving the environment of the eCommerce merchant. For businesses, an example would be a merchant or restaurant leveraging a point-of-sale platform that also includes an embedded inventory-based financing service that has direct access to the sales and revenue information necessary to quickly make credit decisions and deliver needed financing.

It's important to note that building and powering capabilities like that takes a lot of heavy lifting on the back end. It requires a technical infrastructure that's flexible and customizable to connect multiple services, typically through application programming interfaces, which enable the different platforms involved — including banks, FinTechs and the customer-facing services — to "talk to" each other behind the scenes and create a seamless and smooth experience for the end user.

It's a significant amount of work, but it's absolutely critical because creating those positive experiences are the key to driving usage and engagement for consumers and business users over the long term.

PYMNTS Intelligence

With Digital Payment Needs Growing, **Embedded Finance Can Help**



THE BANKING AND FINANCIAL SERVICES INDUSTRY IS UNDERGOING A RAPID DIGITAL TRANSFORMATION.

In response to the pandemic and the emergence of new technologies, consumers are rapidly exchanging traditional financial products and services for innovative digital solutions. Though this digital shift impacts nearly all aspects of banking and finance, the rise of digital payments stands out. Both individual consumers and companies increasingly use, expect and, in many cases, need digital payment solutions, and they are expecting FIs to provide them.

However, not all digital payment solutions will do. Informed by the quick, convenient experiences they encounter on the internet, consumers expect similarly seamless, digital-based payments experiences — the kinds that embedded finance can provide. This month, PYMNTS examines how consumers' and businesses' digital payments expectations are evolving and how FIs can leverage embedded finance to create better digital payment experiences.

DIGITAL PAYMENT USE IS STRONG AND GROWING

Consumers are utilizing digital payment channels like never before. For example, more consumers are using digital wallets. Of consumers who reported that their payment habits changed due to the pandemic, one-quarter said they are using digital wallets more frequently than they were a year ago. In another study, 42% of consumers reported having made a payment through a digital wallet, such as Apple Pay, in the past six months. The same study also underscored the widespread use of other digital channels. For example, 23% of consumers made a payment directly through a social media platform, and 19% purchased something within a video game or other virtual space. No matter the channel, consumers want their payment experience to be secure, fast and seamless.

Businesses have similar expectations for digital payments. Like consumers, they want to use digital channels to pay their suppliers and other businesses, and they expect FIs to provide this functionality. Furthermore, with customers wanting to pay for goods and services through seamless digital channels, businesses are looking to provide digital solutions. So far, many have been largely successful: As of October 2021, 61% of merchants were supporting digital wallets at checkout — yet businesses know they need to do more. That is why they want FIs to provide solutions they can easily integrate into their existing infrastructures and product offerings.

CONSUMERS WANT EMBEDDED FINANCE, WHETHER THEY KNOW IT OR NOT

At first glance, it might appear that most consumers do not want or care about embedded payments or embedded finance. For example, nearly half of consumers have never heard the term “embedded payments.” Of the 51% who had heard the term, 23% did not understand what it meant. Another report found that approximately one in 10 consumers are familiar with embedded finance. Nonetheless, many consumers are currently using embedded experiences whether they know it or not. Nearly one-third of U.S. consumers have used embedded payments just through using rideshare apps, and more than 40% of consumers have used digital wallets — two notable examples of embedded payments.

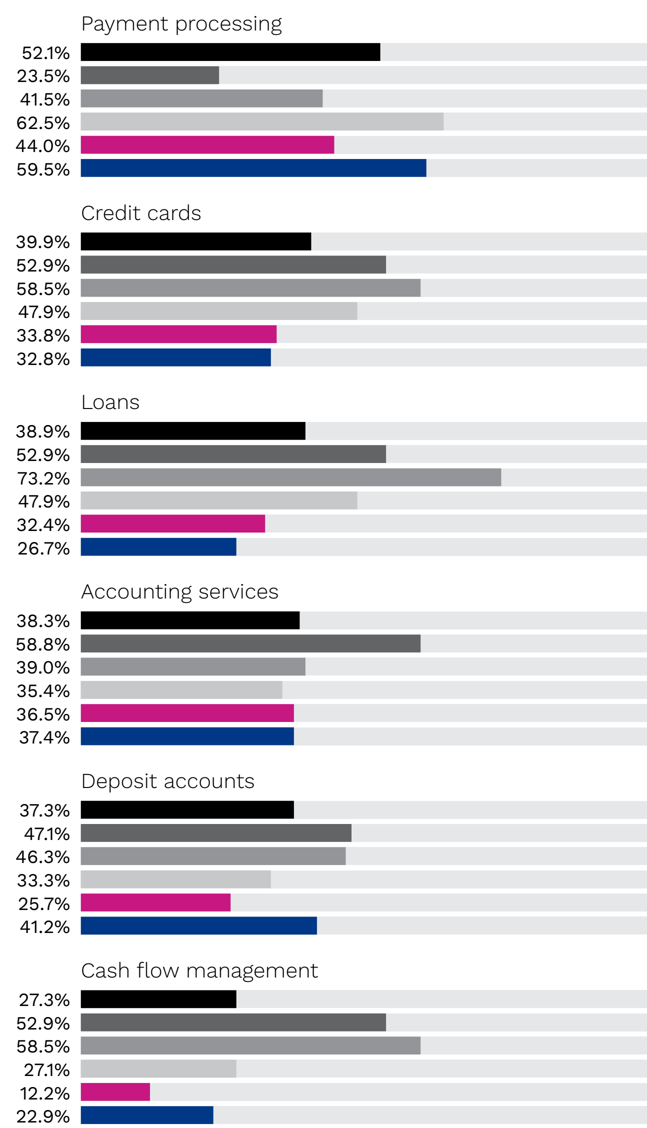
EMBEDDED FINANCE HAS MORE TO OFFER

Although consumers and businesses are already leveraging embedded finance to great effect, it still has more to offer. Many consumers want further functionality that would require embedded finance. For example, nearly half of consumers said they would likely use banking services provided by their streaming providers, internet providers and even their employers. The same study found that more than one-third of consumers are interested in using digital or social brands to send money to their friends.

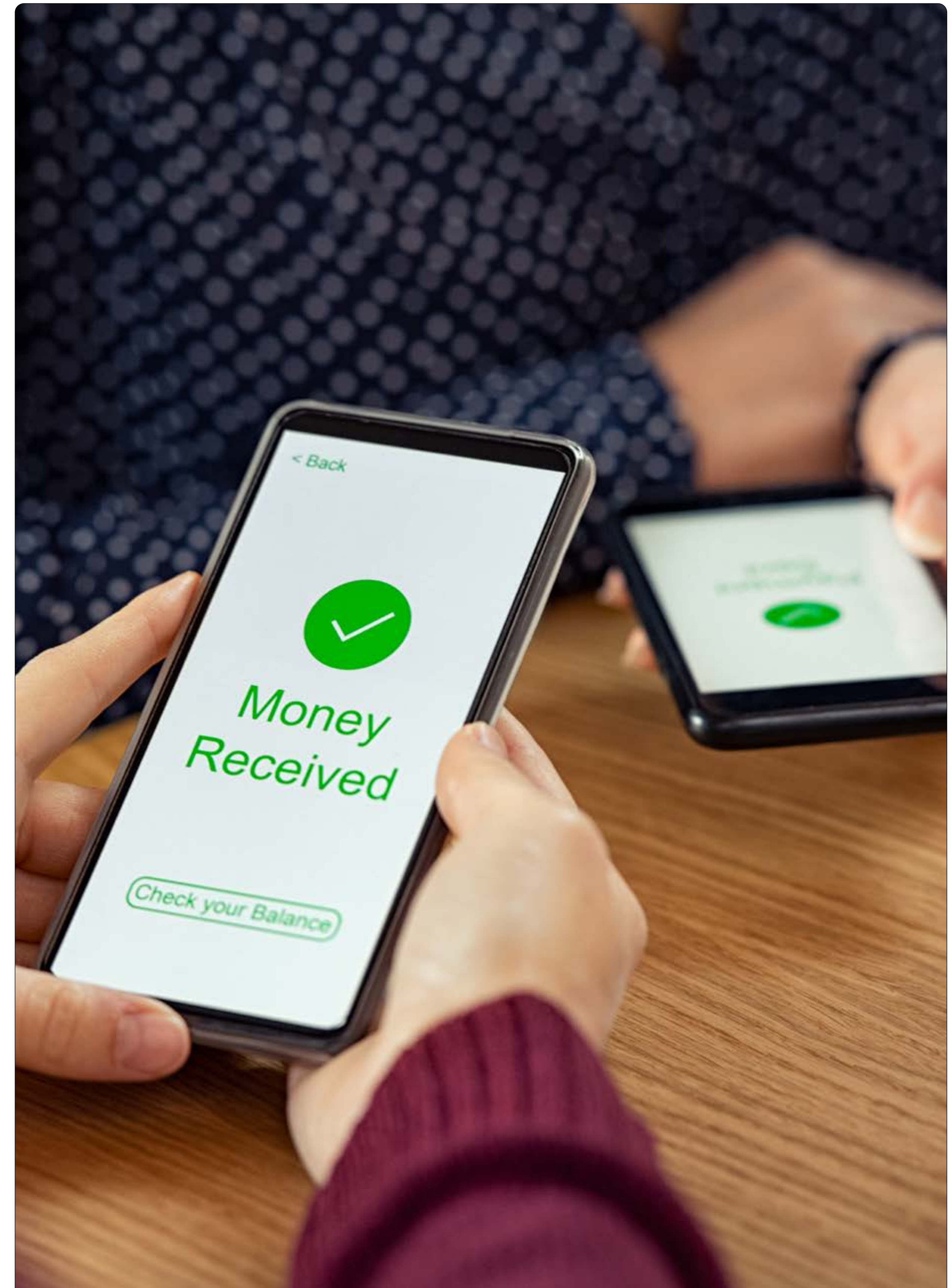
FIs are aware of embedded finances' potential. According to PYMNTS' research, 92% of FIs report they are planning to innovate or are currently innovating embedded finance experiences. As the need for seamless digital experiences continues to grow, embedded finance can and will increasingly be used to provide these types of solutions.

FIGURE 1:

Embedded finance experiences FIs plan to innovate
Share of FIs planning to innovate select embedded finance experiences, by type of FI



Source: PYMNTS
Meeting The Challenge Of Payments Modernization, May 2022
N = 311: Whole sample, fielded Oct. 28, 2021 – Nov. 30, 2021



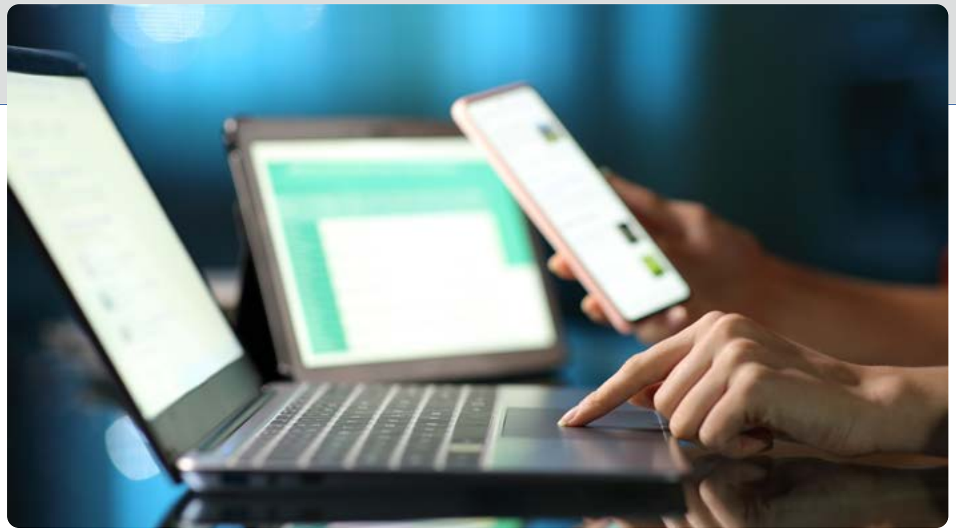
NEWS & TRENDS

EMBEDDED FINANCE FOR **BUSINESSES AND CONSUMERS ALIKE**

CONSUMERS INTERESTED IN MORE DIGITAL SERVICES FROM THEIR FINANCIAL ADVISORS, SURVEY FINDS

The interest in using digital solutions to manage financial affairs extends beyond just banking. A recent survey of 2,158 consumers found that 58% of respondents viewed investment, money management and other financial apps as key to meeting their financial objectives. This could mean that consumers want apps that do the work for them, with 54% of respondents wishing for technology capable of completely handling their personal finances. Interest in digital apps remained strong even among respondents currently working with financial advisors, with 76% of this group expressing such interest.

Despite substantial preference for digital apps, human touch remains an essential component. Nearly six in 10 respondents trust human financial advisors over their digital equivalents. This preference was unsurprisingly prevalent among Generation X and baby boomer respondents. Millennials also expressed this opinion, indicating that even tech-savvy consumers want at least some human involvement. Mary Ellen Dugan, chief marketing officer at Envestnet, explained that these findings make it clear that the financial industry must balance human-centric assistance with integrated technology engagement via financial apps and embedded finance.



GALILEO CEO: EMBEDDED FINANCE CAN CREATE A BETTER B2B BRAND EXPERIENCE

The B2B world could also benefit from embedded finance, according to a recent interview PYMNTS' Karen Webster conducted with Derek White, CEO of Galileo. White explained that embedded finance can cause a profound shift not just in consumers' day-to-day financial lives but also in B2B payments, potentially changing the way trillions of dollars flow between suppliers and buyers. The online ecosystems at the heart of embedded finance offer seamless, multilayered interactions such as blogs. These interactions can serve as monetization channels for goods mentioned within a post, making it far easier for firms to work with and pay other businesses.

Galileo is being increasingly pulled into the B2B space as it responds to growing corporate interest in virtual cards over physical cards and checks, White explained. Checks still account for over 50% of B2B payments, he added, meaning there is much work to be done. He also noted that there are four key areas in which embedded finance can provide value: payment speed, increased spending power via the extension of credit, insurance issuance and the creation of a B2B "brand" where the intersection of use cases and experiences contributes to customer satisfaction and loyalty.

FIs MUST DO MORE TO **UNLEASH EMBEDDED BANKING'S FULL POTENTIAL**

BANK CUSTOMERS' DESIRE FOR MORE ROBUST MOBILE OPTIONS NOT BEING MET

Despite wanting more personalized mobile banking experiences, most consumers are either dissatisfied with their current options or not getting any at all, according to a recent survey. The findings — drawn from a sample of 3,000 financial service customers in more than 15 countries — show that 93% of respondents want personalized financial assessments from their banks, but only 30% have received the interactions they expect.

This gap between expectation and reality frustrates consumers, with 53% of respondents feeling frustrated that they could not reply to mobile messages from their banks, for example. Interest in personalized mobile experiences is greatest among younger consumers, according to the survey, meaning this important demographic is particularly frustrated. Dissatisfaction over lack of mobile functionality could even cause some of these consumers to switch banks: One in three respondents under the age of 40 reported switching banks to obtain better mobile experiences.

WIDE GAP BETWEEN MILLENNIALS' AND BANKS' INTEREST IN VOICE-ACTIVATED ASSISTANTS

Among the myriad technologies younger consumers want to access when banking via mobile apps, one area stands out in which banks are falling short: voice-activated assistants. In a recent survey of 8,000 banking customers, nearly half cited voice-activated assistants as a feature they most want to see. Banks are significantly less keen on this technology, with only 35% of banking executives considering voice-activated functionalities as a priority.

Millennials are entering their prime spending years and, at a population of about 1.8 billion worldwide, represent 23% of all consumers. Notably, this is a generation that is not inclined to interact with banks in the first place. One study found that 71% of millennials would rather go to the dentist than interact with their banks. Banks should therefore reconsider their stance on voice-activated assistants, as meeting millennials' digital expectations will become more important than ever as their spending power grows.

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ABOUT

PYMNTS

PYMNTS is where the best minds and the best content meet on the web to learn about "What's Next" in payments and commerce. Our interactive platform is reinventing the way in which companies in payments share relevant information about the initiatives that shape the future of this dynamic sector and make news. Our data and analytics team includes economists, data scientists and industry analysts who work with companies to measure and quantify the innovation that is at the cutting edge of this new world.

GALILEO

Galileo is a leading financial technology company whose platform, open API technology and proven expertise enable FinTechs and emerging and established brands to create differentiated financial solutions that expand the financial frontier. Galileo removes the complexity from payments and financial services innovation by providing flexible, open API building blocks and a secure, scalable, future-proof platform. Trusted by digital banking heavyweights, early stage innovators and enterprise clients alike, Galileo supports issuing physical and virtual payment cards, mobile push provisioning and more, across industries and geographies. Headquartered in Salt Lake City, Galileo has offices in Mexico City, New York City, San Francisco and Seattle. Learn more at galileo-ft.com.

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