
# Improving efficiency in international payments

Straight-through processing offers many advantages but for it to work effectively Jeffrey Borenstein of NACHA believes new standards need to be standardised.

Spurred on by intense competition, financial institutions have embraced the concept of straight-through-processing (STP) as a way of improving their operational efficiency The need for STP is especially clear in the realm of cross-border payments.

STP is that from the time a payment instruction is generated to the execution of the payment at the receiving bank, no human intervention is necessary. Automation will reduce operational costs, increase processing capacity, improve throughput, reduce error rates and lower risk.

***What is required for STP to work?***

STP, while simple in theory, requires a great deal of co-operation among the participants. The basic requirement is a common channel that allows the participants to communicate. Payments must be generated in a format that can be understood by every system in the chain, and this requires the creation of a clear, unambiguous and rigidly enforced standard method for presenting data, or a standardised way of converting from one format to another.

Similarly, the correct information must be entered at the start of the transaction to avoid the need for human repair of incorrect data, and this requires an understanding as to what information is necessary to process a transaction.

***International payment problems***

There are two types of problems that prevent STP of international payments: payment channels and data quality. Unsurprisingly, both factors are interrelated – the nature of the current payments channel demands flexibility in the composition of messages and this leads to poor data quality.

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In the absence of a central settlement point, banks must rely on complex and extensive networks of correspondent banking relationships to settle international payments. Transactions are therefore processed from correspondent to correspondent until the funds reach the beneficiaries' accounts.

As a result, payment messages require comprehensive routing detail to enable delivery to the final receiving point. The requirement for more data, however, makes it more challenging for originators and their banks to know and include all of the necessary information and to adhere rigorously to codes that would otherwise enable STP. Moreover, it further follows that the chance for inaccuracy increases with the complexity and extent of data required, as well as with every additional handling point for the message. The result is that a staggering 62% of SWIFT MT100 messages (the staple of international payment transactions) require human intervention.

Data that fails to fully conform to established standards is commonly accepted throughout the processing chain. More than 40% of SWIFT MT100 messages identify the beneficiary bank by name rather than by a unique clearing code understood by a machine. An additional 16% of international transfers contain a beneficiary account number that does not follow the same structure of the beneficiary country. Another 7% do not include the beneficiary's account number at all. This shows that at some point human intervention is needed to examine the payment and repair the incorrect data, which is an expensive and often inefficient process.

***Continuing problems***

The biggest recurring problem is that the originators are simply not familiar with the payment clearing rules of every country to which they send payments. With bank identification codes there is both an international standard – the bank identifier code (BIC) promoted by Swift – and usually a domestic sort code as well, whose structure is determined on a country-by-country basis. While a BIC may be sufficient to deliver a payment in some countries, in others, including the US and the UK, it is not.

Another difficulty is that the standards for communicating international transfers are not standardised. Unlike domestic automated clearing house (ACH) formats, which tend to have fixed fields and strict rules about how those fields are filled, SWIFT messages are necessarily flexible because they are designed for use across a broad spectrum of countries using different practices and rules. The problem of banks being identified with a name can only happen because the standard allows it.

The originator also has little incentive to ensure its payments are entered in an STP-compliant way. Confronted with the difficulties of operating in the international environment, it is easier for the originator to create a payment using whatever data it has to hand and to trust

that the bank will be able to decipher it, even if that involves an expensive manual repair.

### *The way forward*

A number of initiatives are now under development or beginning to operate that should dramatically improve this state of affairs. Two of these, the Euro Banking Association's (EBA) Straight-Through Euro Processing System (STEPS) and the Worldwide Automated Transaction Clearing House (WATCH), are particularly promising in that they look to expand the basic efficiencies of domestic ACH processing to the cross-border world.

Domestic ACHs and similar clearing arrangements are low value payment systems that are admirably STP-compliant. They provide a cheap, efficient and easy means of making payments – largely as a result of their highly automated environment, using rigid standard formats and batch processing to drive down costs.

The EBA has launched STEPS as an initiative to promote STP of payment orders – and over time of the whole transaction – within the European context. As a short-term measure, it has introduced Step1, a single-entry processing system that allows for individual payment orders to be exchanged and processed among the EBA participant credit institutions, which span all of the EU countries. Longer-term, the EBA is exploring the possibility of introducing a batch-based, ACH-like system for Europe that will also meet the expanding need for e-enabled payments. The specific details are still unclear, but both initiatives signal the EBA's commitment to providing a marked improvement in STP and the process of cross-border payments in the EU.

Watch, on the other hand, seeks to leverage the advantages of the existing clearing infrastructures – the domestic ACHs. As illustrated in *Figure 1*, Watch will accept payments from member financial institutions and their sponsored originators in a variety of domestic formats – ANSI X.12, EDIFACT, SWIFT, and NACHA – and will then translate from the input format to the appropriate format for the receiving country. The resulting output file will be sent via the usual domestic clearing stream as a quasi-domestic payment. Settlement is arranged in a similarly straightforward way, with a single payment per currency per day in RTGS funds to WATCH and distribution by WATCH via the domestic ACH settlement process.

As it so closely resembles the process for a domestic ACH, Watch will allow cross-border payments to approach the same level of automation and efficiency currently enjoyed by ACH users. Also, the use of domestic ACHs allows WATCH members to send a payment to any recipient in the destination country connected to the domestic clearing system (virtually every bank account), regardless of whether the receiving bank is a member of WATCH. This will in effect create a straightforward payment channel required for STP.

WATCH will also help facilitate STP in two key ways:

- by providing the means through which, say, a UK company's systems can generate a payment understood by a US bank; and
- by ensuring that the information is provided in the correct manner for that payment instruction to be meaningful to the receiving bank.

WATCH is, in essence, an interpreter between domestic clearing systems. It allows for financial institutions and companies to submit payments using formats with which they are already familiar and for which their systems are already designed. It then translates that message into the familiar format of the receiver for which its systems are designed. However, seamless communication is not useful if the information communicated is not meaningful. As the interpreter, WATCH understands what information is needed in the receiving country and will structure the rules for its payments accordingly. Payments going to the UK, for example, will require a UK banking sort code, and so any WATCH payments destined to the UK will require that a UK sort code be included. These rules and guidelines will be clearly specified and provided to the originators for incorporation into their systems, so any payments generated for a destination country should be processable straight-through because they will contain all of the appropriate data.

Like an ACH, WATCH will perform a validation check on every payment sent into the system, and those payments that do not meet the WATCH rules will be returned to the originator.

### *On the right track*

Regardless of the method used and despite the obvious obstacles, it is clear that STP in cross-border payments will provide significant advantages in terms of efficiency and reduced costs across the value chain. It will allow for payments to be sent cheaply, and in most cases faster, and the improved efficiency of the bank will accentuate the efficiency of its customers. Financial institutions participating in initiatives to facilitate STP will therefore be more attractive partners for corporations seeking to optimize their relationships. ■

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*FIGURE 1*