

## **How the Treasurer Can Help Banks Cut International Payments Costs**

***Marcus Hughes - Bottomline Technologies - 10 July 2003***

---

Today, cross-border payments can be more than one hundred times more expensive than domestic ACH (Automated Clearing House) payments. This untenable situation is at last set to change as both regulatory and competitive pressures are now forcing banks to reduce pricing on their cross-border payments business. However, corporate treasurers would be advised to take a number of steps themselves in order to ensure maximum benefit from this development, since the banks are not in a position to take all the strain in this major change process and the corporates too have a key role to play. This co-operation is undoubtedly in the common interests of both the banks and the corporate sector in order to drive down processing costs which in turn affect the pricing the banks apply to their customers.

### **New EU Cross-border Payment Regulation**

As we should all know by now, from 1 July 2003, EU Regulation 2560/2001 requires that cross-border payments denominated in euro up to a value of EUR12,500 must cost no more than domestic payments. From January 2006 the threshold will be raised to EUR50,000, which means that over 85 per cent of cross-border commercial credit transfers must be priced at domestic ACH (Automated Clearing House) levels. It is estimated that the banks will lose more than EUR1 billion in revenue as a result of the new EU regulation. Furthermore, this regulation – together with competitive pressures – will have a progressive, knock-on effect on other currencies and payment values both inside and outside the EU, so bringing to an end the opaque and high tariffs historically charged by banks.

The basic problem is that banks currently incur far higher costs to process cross-border payments than in their domestic clearing arrangements. Whilst varying widely in format and practice from one country to another, in most economically advanced countries domestic payments have generally become relatively efficient and standardised in each local market, to the point where they are now commoditised and hence significantly cheaper. However, as far as international payments are concerned, recent research from SWIFT (the financial messaging infrastructure provider) indicates that 25 per cent of cross-border commercial payments do not contain the correct payment information and consequently result in failure. It is estimated that each failed cross-border payment costs up to EUR30 to fix, hence the higher charges applied by banks on international payments.

### **The need for clean payment data to achieve STP**

With banks beginning to differentiate between STP and non-STP payments, the key challenge is to improve the quality and integrity of data included in the payment instructions that a corporate submits to its bankers. The banks and payment infrastructure providers such as SWIFT can provide improved tools and data bases to help the corporate, but ultimately it is the corporate who carries responsibility for ensuring that the beneficiary account is suitably identified to enable the payment to reach that account with minimum manual intervention and hence with the lowest possible processing cost.

Increasingly, corporates are realising that a ready-made solution is not available from the banks or the vendors of traditional treasury management workstations or ERP (Enterprise Resource Planning) systems. Surprisingly, it is still the case today that payment data output from some major ERP systems is not in a format that corresponds to the requirements of a number of the cash management banks. Middleware may have lost something of its previous allure since the dotcom era, but the kind of 'disconnect' described above suggests a need for a web-based payment consolidation tool or 'gateway' application which enables treasurers to manage all their payments and reporting requirements from a single platform.

The adoption of such a solution can greatly assist in the preparation, formatting, validation, approval and release to the bank of clean payment instructions. Using proprietary bank software leaves the corporate with similar problems as today: Multiple bank interfaces, diverse message formats, sundry security protocols and typically 'thick client' desktop solutions which lack the pan-enterprise visibility and remote access available from web-enabled systems. With these old systems, payment files from an ERP system still need to be imported manually and loaded into different bank software packages, often in slightly different formats for each bank. This process can expose the files to fraud and error and, in some cases, can involve time-consuming re-keying.

### **A helping hand from SWIFT and the EBA**

To help reduce processing costs on cross-border payments, SWIFT has developed a new single payment message, the MT103 which is more structured than its predecessor the MT100, (which has been in use for over 20 years and is finally to be withdrawn from service in November 2003). For optimum STP, the so-called MT103+ has been created. This new message makes the inclusion of the IBAN and the BIC mandatory (described in the next section below). Such routing information makes the MT103+ the most 'STP-able' of payment types for single payments. For bulk payments SWIFT has developed the STP Bulk Credit Transfer which also includes the mandatory use of IBANs and BICs. Today's payment 'gateways' are configured to generate these types of payment message automatically, drawing the correct data from easily accessed tables, in order to minimise manual intervention at the bank, thereby attracting the best possible pricing.

These new SWIFT formats will be used by the EBA (Euro Banking Association) in their latest initiative known as STEP 2 (Straight Through euro Processing) to create a pan-European ACH, currently being successfully piloted by 30 major payments banks across Europe. In this way, the EBA is positioning itself to help banks comply with the new EU Regulations on low value cross-border credit transfers and ultimately help achieve the European banking industry's stated vision to develop a Single euro Payment Area (SEPA). Future phases of the EBA's roll-out include the creation of a pan-European direct debit system (by mid-2005), as well as possibly enabling corporates to submit their payment files direct to the EBA (a proposal sometimes referred to as STEP 3). Such a development would have interesting parallels with BACS in the UK, which unlike other ACH systems across Europe, allows some 50,000 corporates to submit files direct to the BACS clearing system, providing a high degree of efficiency and cost savings.

### **Vital enablers: The BIC and the IBAN**

In order to qualify for lower pricing required by the new EU regulations, banks will insist that their customers submit payment instructions with complete payment details so that they can achieve straight-through processing. This is the only way that banks can comply with the new regulations. In the same way that domestic payments in, say, the UK only attract cheap pricing if they contain properly formatted account number and sort code (branch code) details, corporates must ensure that the payment instruction is suitably formatted, including BIC and IBAN (Individual Bank Account Number) details, in order to achieve equivalent low pricing on cross-border payments.

The IBAN is a unique identifier for bank accounts formatted according to internationally agreed standards. The data elements and length of an IBAN vary by country, but in broad terms they incorporate a country code, two check digits, a bank code and / or a branch code and an account number (also known as the Basic Bank Account Number, or BBAN). In this context of cross-border payments, the BIC is a SWIFT Bank Identifier Code used to uniquely identify the bank's payment processing office to which a payment instruction is being sent. Efficient use by the corporate of the BIC and IBAN, two vital enablers, is now key in achieving STP in cross-border payments and hence qualifying for lower bank charges.

### **Early Validation of IBANs and BICs**

Corporates have responsibility for sharing their BIC and IBAN with their trading partners and for ensuring the BIC and IBAN are correctly included within payment instructions. Where required, an efficient payment consolidation

tool can generate an IBAN based on a BBAN and, most importantly, it can automatically carry out full validation, using both the country specific algorithm and subsequently the IBAN algorithm. There are now over 20 countries, including all EU member states, actively promoting the use of IBANS and it is anticipated that the IBAN will grow in usage from this summer onwards. Interactive use of the latest databases automatically matches an IBAN with a particular bank and branch, enabling the user to check or identify exactly where the account is held. To achieve STP it is also extremely advantageous to be able to automatically match the IBAN with the appropriate SWIFT BIC in order to uniquely identify where the receiving bank takes euro denominated commercial payments. These steps are vital in creating properly formatted MT103+ messages (including the corresponding BIC plus IBAN), thus maximising payments that can be straight-through processed.

Thus in order to raise the quality of payment files submitted to their banks, corporates need to make greater use of online databases such as pop-up windows of BICS and IBANS to uniquely identify the account to which a payment is to be sent. These pop-ups can be easily searched and traversed to identify the appropriate code and populate the payment screen speedily. Databases of national bank and branch codes are also available, such as UK Sort Codes, the USA's ABA codes and Germany's BLZ codes. IBAN, BIC and domestic branch code validation can also be achieved with bulk payment files imported from a corporate's ERP system. For batch data, the system first checks the file for all mandatory fields. Once these criteria have been met, all of the transaction STP rules are checked. These rules can be based on customer-specific business logic. Any items not meeting defined STP requirements are separated for review and edit by the user and subsequent release to the bank. In this way, by pre-validating payment instructions before files are submitted to the bank, the corporate can attract reduced pricing on its payments.

### **Split Pricing on STP and non-STP payments**

In those cases where customers are unable to provide complete payment information (including BIC plus IBAN) banks are likely to apply differential tariffs: Where the bank has to "repair" a payment, by incorporating additional payment data, typically through manual intervention, it will apply a higher charge to compensate for the extra work involved. However, for those payments which pass straight through the bank's systems, without the need for manual intervention or "repair", these payments will qualify for lower charges. It is quite possible that some of these manually "repaired" payments will attract penal rates, even higher than today's pricing, as a means of encouraging customers to provide clean payment data to their bankers.

### **Customised payment screens and mandatory fields**

The kind of payment solution we have discussed in this article plays a key role in integrating with a corporate's ERP system and can therefore securely close the "disconnect" or "air gap" between the corporate's back-office and the banking network. It supports all payment types (including RTGS, ACH, cross-border and cheque) which can either be keyed individually (with automatic update of the ERP system) or via file import. A key requirement of the treasurer is the ability to ensure payment instructions are correctly formatted to meet the requirements of the paying bank and the most appropriate clearing system to be used. Thus, the treasurer requires the option to validate and reformat payment files prepared in the ERP system before approval and submission to the bank. Manual data entry screens can be customised to suit the needs of individual payment units within a business, along with the use of templates, drop-down payee lists and accounts to debit, as well as mandatory fields to ensure compliance with the payment type and a bank's possible proprietary requirements. All these tools help to reduce manual keying and therefore minimise the risk of errors.

An efficient payment gateway solution also incorporates a flexible remittance advice solution, enabling remittance details to be issued by fax, in paper form as well as via email with a hyperlink (and password) back to a payer's website, thus enabling the beneficiary to download remittance details in the format required to achieve automatic reconciliation in his accounts receivable system.

## **Converting cross-border payments into domestic payments**

Some corporates have already adopted a cash management policy of converting international payments into domestic payments wherever payment volumes are sufficiently high. This can be achieved by sending payment files to a bank with access to domestic clearing in the countries to which significant numbers of payments need to be made. Rather than paying cross-border tariffs, the corporate can attract domestic pricing, provided the payments are suitably formatted to meet local clearing requirements. Such a structure can be created by using a global / regional cash management bank which has access to a number of local clearing systems or, alternatively, by establishing a direct relationship with banks in the countries to which large volumes of payments need to be made. In the latter case, it is necessary to open accounts with each of the local banks and these accounts will need to be funded by occasional cross-border payments (of sufficient value to cover the total local payments to be made plus charges) timed to arrive shortly before the bulk payment files are submitted to the in-country bank for local distribution. The structures outlined in this paragraph are only suitable where there is a significant concentration of payments into one or more countries, but would be less appropriate where payees are thinly spread over a wide range of countries.

A good payment consolidation tool can handle data in virtually any accounting system format (ASCII, XML, CSV, EDIFACT etc). Using flexible business rules, incoming data can be reformatted automatically to comply with any payment format, including proprietary local formats and bespoke bank formats. Thus rules can be built to ensure manually keyed or file uploads comply, not only with the corporate's bank's back-end systems, but also with any onward routing to a correspondent bank, messaging network or clearing system. Similarly, a web-based payment gateway solution can be used to manage remote accounts in other countries in order to initiate payments and receive balance and transaction reporting.

## **Conclusion**

So the key enablers have been developed, in particular the MT103+, the BIC and the IBAN. But to achieve optimum usage of these tools a web-based payment consolidation tool provides a practical way of harnessing their capability through a single platform, offering easy pan-enterprise access to the appropriate databases and automatic pre-validation of single payments and payment files before release to the bank. There is a double benefit here for the corporate, since it can not only reduce bank charges by qualifying for STP payment tariffs at the bank, but the corporate can also cut its own processing costs through the streamlined management of its preparation and approval workflow, at the same time as improving its operational risk management. This results in bottom line benefits for both the corporate and the bank, which in turn is better able to comply with the new regulations on payment pricing.