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The final approval of the cards framework last month hopefully signals that significant movement towards implementing SEPA is at long last underway. With nearly all the necessary regulation in place, it seems that the spring months will finally bring the implementation and deployment stages to the Eurozone.

Henrik Parl from Eurogino discusses what he thinks will be the next key trend in the industry after the 2008 deadline (see page 9).

SEPA is not the only pressing concern for banks at the moment, Tim Decker from JPMorgan explains why non-STP charging for euro payments is also a serious issue in need of resolution (see page 4).

On a lighter note, April also entails a slew of practical jokes that spring up on the first of the month. In keeping with the industry focus on the Eurozone, I thought I'd highlight a particularly apt April fool of yesteryear.

In 1999, the Today program on BBC Radio 4 announced that the British national anthem was to be replaced by a euro anthem sung in German. The new anthem, which Today played for their listeners, used extracts from Beethoven's music and was sung by pupils of a German school in London. Reportedly, Prince Charles' office telephoned Radio 4 to ask them for a copy of the new anthem. St James' Palace later insisted that it had been playing along with the prank and had never been taken in by it.

Regards, Virginie
Danke Bank has become the first non-UK member of UK-based payments processor BACS Payment Schemes Ltd. The Danish bank joins the electronic payments processor’s current 13 members that include British banks and building societies, such as Abbey, Barclays, Bank of Scotland and Lloyds TSB.

Michael Chambers, managing director of BACS, said: “We are pleased to welcome Danske Bank as a BACS member bank and our first non-UK member. Since the creation of BACS Payment Schemes Ltd at the end of 2003, we have been working towards making membership of BACS more accessible. This latest news shows that we are already some way to achieving this objective.”

This is good news for BACS in the light of impending ACH industry consolidation as a result of the Single Euro Payments Area. Danske Bank will join the existing members in overseeing the running of BACS and its payment services, including direct debit and direct credit, and therefore extend the processor’s credibility in the European payments space.

Danske Bank’s membership also furthers its interests in the UK, following its acquisition of Northern Bank at the end of 2004.

“During Easter of 2006, National Irish Bank and Northern Bank will be migrated to Danske Bank’s central IT platform. In that connection Danske Bank has become a member of BACS. Danske Bank is already a member of retail clearing systems in all other countries where it has retail banking activities,” said Jørgen Klejnstrup, chairman of Danske Bank International.

However, it has not all been good news for the payments processor this month. The Office of Fair Trading’s Payment Systems Task Force has expressed concern about the lack of consumer involvement in the decision-making process of BACS Payment Schemes Ltd. A lack of consumer and business involvement in the governance of BPSL is of particular concern due to the fact that it has a market monopoly in payments processing.

The task force, which was set up in 2004 to resolve payment system issues over a four year period, hopes to enable wider participation in BPSL governance by setting up a forum to brief businesses, consumer groups and other interested industry stakeholders on current and forthcoming issues. This ‘affiliates interest group’ would also allow these groups to influence the decision-making process by raising issues of concern.

Jonathan May, OFT director of markets and policy initiatives and chairman of the task force, said: “Consumers and businesses using BACS can now have a real voice in the future development of BACS payments. This report represents another success for the task force approach and I am grateful to all those who contributed to it.”

As well as the proposed interest group, the task force also recommended that a consultation process be set in place to allow interested parties that are not ‘affiliates’ to contribute their views on BPSL proposals. Furthermore, BPSL will follow a broader objective to promote “efficiency and innovation in payments, responding to user and market needs in an efficient and cost effective manner.”

The BPSL has been charged with the task of implementing these changes over the next 12 months, at which point it will report back to the task force about its progress. To this end, the affiliates group currently comprises 20 organisations including larger businesses and government departments.

The task force is also considering proposals that were put forward by one of its members, the Association for Payment Clearing Services, which would have a significant impact on the governance of a number of payment schemes.
Twist announces collaboration with Bolero

Following last month's announcement about its collaboration with PKI provider Identrus, open standards group Twist has again signed an agreement with another high profile industry body: open platform provider Bolero. Under this cooperation agreement, Bolero will become a member and sponsor of Twist and participate in working groups related to trade finance.

The partnership is aimed at promoting momentum in the delivery of standards in the corporate to bank space, especially with regards to the reflection of corporate needs in these standards.

Arthur Vonechek, chief executive of Bolero, explained: “There is a fundamental shift underway from proprietary bank-centric solutions to corporate-centric multi-banking and standards. Twist’s emergence in support of the standardisation of transactions between banks and their corporate customers is a very important initiative for the industry. In pursuit of the same strategic goals, cooperation between Twist and Bolero will provide clear added value for our customers and the community in general, as well as reciprocal value.”

Despite the common industry perception of Bolero as a standards body, which was its original purpose at its inception, it is not in competition with Twist. Bolero provides an open platform to enable paperless trading for the merging of the physical and financial supply chain, whereas Twist remains engaged in developing common standards in this space.

Tom Buschman, chairman and chief executive of Twist, commented: “The domain expertise Bolero has gathered in the effective implementation of the entire letter of credit and guarantees lifecycles for both importers and exporters and their banking partners has resulted in a unique understanding of the standards required to support this activity between the corporate and its banks. Contributing this knowledge capital to the Twist program provides a fast-start to the effective adoption of Twist standards in this space.”

Accordingly, Bolero has said that it will contribute its expertise in these areas as a basis for the creation of formalised Twist standards in the future and support the mapping of these standards onto the Bolero multi-bank automation platform. Earlier in the year, Bolero completed a new internal funding round led by its existing investors and attributed this to the rising interest of the market in its platform. At this time, it announced a further seven financial firms that have gone live with the platform: Credit Suisse, ING Wholesale Banking, Dresdner Bank, Zürcher Kantonalbank, HypoVereinsbank, Fortis Bank and HSH Nordbank.

BIS and World Bank release remittances report

The Bank for International Settlements’ Committee on Payment and Settlement Systems and the World Bank released a consultative report entitled General principles for international remittance services on 13 March. It provides an analysis of the payment system aspects of remittances, on the basis of which it sets out general principles designed to assist countries that want to improve the market for remittance services.

The report, which was prepared for the CPSS and the World Bank by a taskforce consisting of representatives from international financial institutions and from central banks in both remittance-sending and remittance-receiving countries, deals with the practical realities of how money is transferred during the remittance process. It provides five general principles for the remittance market dealing with five areas: transparency and consumer protection; payment system infrastructure; the legal and regulatory framework; market structure and competition; and governance and risk management.

Co-chairmen of the report, Marc Hollander, head of secretariat at the CPSS, and Massimo Cirasino, senior financial sector specialist at the World Bank, explained: “Understanding these payment system aspects is crucial to understanding remittances and to ensuring that remittance services are safe and efficient.”

The report is being issued as a consultation document and comments are invited from any interested parties, which must be submitted to either the CPSS or the World Bank by 18 August.

SEPA Cards Framework finally released

Despite the delays and uncertainty that has surrounded many aspects of the Single Euro Payments Area over the last year, it appears that resolution for one of the remaining outstanding issues is finally at hand as the European Payments Council approved the SEPA Cards Framework on 8 March.

Gerard Hartsink, EPC chair, said: “I am delighted with the consensus that we have achieved and the progress that we continue to make in this ambitious programme”.

The framework provides the high level principles and rules that are aimed at enabling European customers to use general purpose cards to make cash payments and withdrawals in euro throughout the Eurozone in the same manner as their own domestic payments. It uses a three tier model for progress that encompasses the framework itself, the card schemes and the infrastructure providers.

The framework is the actual document to which banks and card schemes in the Eurozone must commit in order to address the expectations of the EPC, the European Central Bank and the European Commission for SEPA.

The other two tiers of the model deal with the practical realities for those involved in SEPA. The second tier deals with the context within which the card schemes and their members must operate in order to ensure interoperability and competition. The third and final tier deals with these same two issues for the providers of technical infrastructures and payment services, with a view to efficient and low cost processing.

The implementation of SEPA for cards is seen by the EPC as a two-stage process where banks ensure that the payment schemes of which they are participants become compliant, and these banks then deliver accordingly compliant payment products to their customers.

“From our point of view, it’s a positive move forward for Europe,” said Eric Tomlinson, senior vice-president for debit products at MasterCard Europe. “Obviously with so many interests involved there will be some compromises, as well as some grey areas which will have to be interpreted and worked out as we progress.”
Far from straight forward

For many years the cost of making payments has been covered by the use of the charging options defined by Swift. Tim Decker, Euro clearing product manager at JPMorgan Chase and chairman of the Interbank Group on Straight Through Processing Standards and Associated Payment Business Practice, explains why non-STP charging for euro payments is now far from straight-forward.

There are three options under the Swift-defined pricing model for payments. The first involves the originator of the payment choosing to cover the entire cost of the payment by putting “OUR” in the charges indicator of their payment. Subsequently, the various banks in the payment chain pass their charges back to the bank that sent the payment to them, either by invoice, or by use of a Swift message. An alternative also exists for the sending bank to send the charges along with the payment, negating the need for the receiving bank to send out a charges claim.

Alternatively, the originator of the payment, in agreement with the beneficiary can select “BEN” in the charges indicator of their payment. The various banks involved in making the payment would then cover their charges by making a deduction from the payment principal. The last option, which involves selecting “SHA” as the indicator, means that charges on the sender’s side are assumed by the ordering customer and the beneficiary customer bears the charges on the receiver’s side.

These arrangements have served the industry well in Europe, although there are differences in how they are used in other markets. The advent of the euro in 1999, the use of Target for cross border European payments and the subsequent introduction of EU Regulation
2560/2001, required greater pricing transparency, efficiency and lower costs to the end user. Consequently, a different approach was required for interbank charges.

In 2003 the European Payments Council (EPC) introduced the Interbank Convention on Payments (ICP), which defined STP standards for payments covered by the regulation. It also stated that banks would be entitled to charge the originating bank for any additional work resulting from the receipt of a non-STP basic credit transfer, as of 1 January 2004.

Since the introduction of the ICP, many banks in Europe have started to levy these charges for regulated payments, but additionally have extended this to other euro payments, interbank payments (MT202) and even to payments in other currencies. These charges are meant to encourage the originator of the payment to format it appropriately, which ultimately will lead to greater efficiency.

The argument for payments in which the beneficiary covers the payment costs is that it is inequitable for the customer to pay for the inefficiency of the payment originator. However, non-European banks are of the opinion that the beneficiary already has a contractual relationship with the originator and can use this to exert pressure on them to improve the formatting.

These new “unregulated” business practices, for example, those outside the scope of the ICP, have led to considerable market confusion and inefficiency. As a result of this, banks have had to introduce processes to handle these claims. Many banks around the world, including several European banks, do not recognise the validity of these non-STP charges or the need for them. They say that the cost of payment processing, including the need to handle some payments manually, should be covered by the existing international market practice of the use of BEN, SHA or OUR indicators.

In addition to this, some of the reasons for the charges are outside the control of the originating bank. For example, many banks outside Europe do not have a Bank Identifier Code (BIC), so it is inappropriate for a non-STP charge to be levied for one being provided. In 2005, the International Financial Services Association (IFSA) wrote to the EPC requesting that the two organisations work together to establish guidelines for euro payments originating outside the EU/EEA.

In that same year, this issue became heated as relationships between banks became strained over these issues. JPMorgan Chase, along with a number of other leading global and European banks, formed the Interbank Group on Straight Through Processing Standards and Associated Payment Business Practice to define STP guidelines for euro payments. Importantly, the group decided to define the associated business practices for handling these payments, such as when non-STP fees could be levied and how best to send these charges to other banks.

While the interbank group intends to promote its efforts through the EPC, it recognises that the EPC’s working committee, the Credit Transfers Working Group, may not be able to work on STP guidelines until they are finished defining the new euro Credit Transfer Scheme. In January 2006, the Interbank Group completed its work on defining STP guidelines for non-domestic intra EU/EEA euro payments. This work is now being submitted to the EPC so that it can be more widely accepted across Europe.

One area that the group has fallen short is to agree on is the definition of a set of STP guidelines or business practices for euro payments originating outside the EU.

Tim Decker, Euro clearing product manager at JPMorgan Chase and chairman of the Interbank Group on Straight Through Processing Standards & Associated Payment Business Practice

Figure 1: STP charging
Are you being served?

The future of the payments and cash management business will not be determined by those who simply transform their back offices and re-engineer for greater scale and lower unit costs. Instead, argues Julian Wakeham at Capco, the future may well belong to those who focus on efficiency in the way they engage with and service the customer.

There can be no question that, like death and taxes, we can be certain that continued cost cutting will be a part of the future for those of us in the payments and cash management industry. Our research suggests that despite the cost cutting efforts of recent years, the average efficiency ratio of many payments businesses is 106%. This data is based on normalised client examples, measured by direct costs against direct fees.

Moreover, with fee income and net interest income under pressure from both regulation and competition, the financial dynamics of the business face further, and possibly even accelerating, deterioration. In this environment, continued cost cutting is not a competitive differentiator, it is crucial to simply staying in the game.

With cost cutting being such a vital issue, there can be no question that major change/ transformation programmes are here to stay. A recent Capco survey suggested that leading banks deploying a full range of ‘transformation’ techniques in the back office were achieving up to a 60% reduction in their back office costs. With this sort of success, you might reasonably expect that this will be the key feature of the future for our industry – more cost cutting and efficiency improvements in the back office.

In fact, that is not what we expect. In our view, the question is not whether back office focused transformation programmes are worthwhile – they clearly are – but whether they are in themselves sufficient? Our research suggests that they are not. Instead, we believe that those looking for advantages in efficiency in only the back office may be looking in the wrong place.

What the future holds

Whilst operational efficiency is essential for
any high volume, largely commoditised business, its importance in terms of its ability to change the overall efficiency ratio of the business is limited to its proportion of total costs. In a typical payments and cash management business, our research suggests that back office costs represent only 30% of total costs, with a further 5% being external cost. By contrast, customer-focused costs, such as customer acquisition, sales, market and product management and customer support, represent 65% of the overall cost stack.

Despite the fact that these activities account for over twice as much of the cost stack as processing costs, few banks have deployed initiatives to improve the effectiveness with which they perform these activities. We think that this is a missed opportunity because there are substantial opportunities in the “go-to-market” areas of the business to not only cut costs, but also to grow revenues organically. Whilst these vary substantially from organisation to organisation, Capco’s experience suggests that successful transformation of these functions can result in annualised cost savings of between 22% and 40%, as well as a 6-12% increase in revenue from the existing franchise.

On the revenue side, these benefits are derived at two levels: improved customer satisfaction, which increases the customer’s willingness to spend, and improved pricing alignment, reducing revenue leakage through inappropriate discounting. On the cost side, benefits are generated from focusing sales resources more effectively, improving sales force efficiency, improving returns on product development and optimising the alignment of service resources.

It is to those who are able to realise the benefits of these opportunities that we believe the future truly belongs.

Taking control of your future
The future of payments and cash management businesses lies in successful transformation of the customer-focused end of the business at three levels: segmenting the customer base according to needs and propensity to spend; aligning the sales and service model to the identified customer segments; and deploying a structure that will allow continuous focus on the needs of each segment and optimisation of the offer to that segment. Each of these is addressed below.

Needs-based segmentation
A needs-based segmentation approach requires the bank to develop a set of dimensions against which discrete segments of customers with broadly common needs can be identified. Unfortunately, for most payments and cash management businesses any segmentation that has been done has usually been driven by the nature of the credit relationship with the customer.

“Successful segmentation balances a customer’s needs for a transaction product with the broader relationship needs of the customer”
### Operating model alignment

The segmentation exercise is likely to make the customer-bank interaction increasingly transparent and also highlights how the interaction changes by segment and the degree to which value-added support is required as part of the proposition for each segment. It should highlight which customers require complex support and product bundles, as opposed to those that are largely ‘execution only’, for example, those that place little value on relationship support.

Our research has found that small and/or low margin customers frequently absorb substantial amounts of sales and service effort, whilst high value customers requiring complex levels of support are exposed to standard or inadequate service levels. To achieve model alignment, each element of the sales and service functions should be broken down and then used as building-blocks to achieve correct resource alignment against each segment and interaction type.

Functions that are common across all segments and interactions can be developed into simplified standard robust processes, whilst high-cost/intensity functions can be aligned to segments and interactions where they are appropriate for the value of the segment/interaction. If done correctly, not only is resource allocated more efficiently, but sales and service resource can be trained and rewarded at levels more appropriate to the actual roles they play.

### Driving continuous improvement

The segmentation and model alignment described above should result in substantial resource reallocation. It is this reallocation that will drive many of the benefits discussed earlier. However, the underlying organisational structure may not change substantially. Traditional front-office functions including relationship sales, technical sales, product management, product development, and implementations, customer service functions and back office functions may continue to be the best way to structure an organisational model – given the skill requirements of each function.

However, if front-office transformation is to succeed, the behaviour of the organisation and the way these functions interact with one-another needs to change in order to achieve increasing commercial client orientation. This customer-focused orientation is best achieved by implementing and emphasising a small number of strategic processes that overlay rather than replace traditional functional structures, orchestrating rather than owning resource. When implemented correctly they will ensure that segmentation and the alignment of the organisation remains dynamic, continuously optimising customer experience and profitability.

In our experience, in addition to the standard management processes each functional area is responsible for, we have identified five strategic processes, spanning multiple functions, which are critical to achieving the transformation and management of the payments and cash management business:

- market segmentation;
- proposition design;
- sales and service;
- deal and pipeline management; and
- portfolio management.

In addition to being central to the coordination of the front-office functions, these strategic processes act as interfaces with other areas, such as the back office and broader relationship teams. They allow cross-functional alignment and help ensure internal functions remain customer orientated and aware of the end-to-end implications of the customer and commercial decisions that are being made.

Payments and cash management businesses represent a critical business line to most banks but cost bases are high and margins typically low. A focus on the back office has and is yielding significant value, but for many organisations this will be insufficient to offset the substantial and increasing burden of offering these core services. It will also help to differentiate them from their competitors. In this environment, organisations must realign the business to the customer segments to better leverage their existing franchise.

Julian Wakeham, Partner, Capco
In general, the cross border payment market today is based on correspondent banking. Banks negotiate bilateral deals in which they, on one hand, aim at being able to send payments at the lowest possible cost and, on the other hand, seek to receive as many payments as possible, thereby maximising fees. The game played is reciprocity where the banks’ income consists of float, interbank fees, foreign exchange, and customer fees, and in certain cases, rebates from intermediaries. It is an income game where costs are not the first focus point and where the customers are often the ones that pay for it all.

In Europe, SEPA will dramatically change all this. Firstly, SEPA payments will become domestic with domestic pricing. Secondly, the euro area has for some time already been experiencing a reduction in foreign exchange income. And thirdly, the New Legal Framework significantly limits the banks’ ability to create income from float and interbank fees. This will mean that the basic focus for banks will change from revenue growth to processing payments in the most cost effective and reliable way. Therefore, cost efficiency and not reciprocity becomes the key word. SEPA is forcing financial institutions to rethink their business models. Not only will we see the emergence of clearing and settlement mechanisms, such as pan-European ACHs, SEPA-compliant ACHs and bilateral/multilateral arrangements, but we will also see an increased incentive to outsource extended parts of the payments process. A lot of financial organisations will have a cost saving opportunity from outsourcing their processing to a few specialist processors or factories, which are able to achieve a positive business case through very high volumes. This can be done on a ‘white label’ basis so that the financial institutions maintain their customer relationships.

At the moment all attention is centred on euro payments, but soon the focus will also move towards restructuring international payments in general. Many financial institutions may achieve significant cost savings by reforming traditional correspondent banking and international departments. Introducing new business models for “true international payments”, including the outsourcing of international payments to processors, correspondent banking network providers and other kinds of facilitators, is a logical consequence of the introduction of SEPA. Henrik Parl, managing director of Eurogiro, explains.

SEPA

Future refocus
Up until now there has been remarkably little development in the global correspondent banking set up. This is partly due to traditions and historic investments made by banks, and also due to the fact that the correspondent banking set up has been quite profitable. Following SEPA, the situation may be quite different. Firstly, SEPA may inspire the global community, including governments as well as banks themselves, to seek reduced costs for international transfers.

Secondly, many banks, especially if they are European, will see a large part of their payments becoming domestic, thereby reducing the business case for the correspondent banking set up of their remaining payments. And thirdly, hopefully the SEPA development will be a trigger for the innovative development of new business models, not least because it is likely to lead to margin pressure for global payments.

**Future structures**

In their quest for increased profitability, financial institutions must aim at cost efficiencies by reviewing the value chain for payments. Traditionally they have provided all the services in the value chain as illustrated (see diagram).

At the customer level, all financial institutions would wish to distinguish themselves vis-à-vis their competitors. They would definitely not want to give others access to their customer base, as payments will still be a key future service that can provide the opportunity to cross sell other products. It will, however, increasingly be questioned if processing needs to be performed in-house. The outsourcing arrangements in Germany of Deutsche Bank and Dresdner Bank for payments-processing to Postbank is an illustration of the fact that outsourcing will become more and more a simple matter of business case.

For “true international payments”, in terms of network/routing arrangements, the correspondent banking set up will be highly costly to maintain stand alone. At least for low value payments it can be questioned if there really is a business case for an independent correspondent banking network, except for very large banks. The costs for this network are numerous: internal staff, IT, network providers, bilateral agreements, routing and travel costs. Finforce and Eurogiro are examples of organisations which are already positioned to provide this service to the banking community.

Finally, financial institutions may seek more standardised or multilateral clearing and settlement arrangements, as the maintenance of settlement arrangements and accounts is quite costly. In Europe, EBA and Eurogiro have created multilateral settlement solutions, which in principle could be made global.

Following the reasoning above, we see a picture emerging of financial institutions that focuses on what is essential for them: their customers, while specialist institutions will emerge to facilitate processing, network/routing and clearing and settlement. We might even see these specialists teaming up between themselves or with banks, vendors or IT companies to provide alliances that will enable each of the providers to enhance their offering. Ideally, banks would wish to outsource to one provider or to a group of providers, as simplicity will be an element in achieving cost efficiency. However, it is not likely that any one organisation will be able to do everything for everyone.

The growth in the area of remittances illustrates the potential opportunities for providing efficient low value payment services. Remittances are interesting for the banks, because by providing such services, banks can connect future potential profitable customers to their organisations. However, many banks face grave difficulties in providing such a service.

Firstly, they do not have the expertise in providing the product, for example, the ability to handle immigrants, language skills, and the ability to do cash payments. Secondly, most banks do not have an appropriate correspondent banking network to service remittances because the correspondent banking network is typically built around high value payments. With remittances, a targeted low value payment network is needed, preferably a network with access to rural areas and the ability to handle cash.

This means that it is extremely costly for banks to achieve connectivity for remittances that can enable a competitive global reach. Moreover, compliance complicates the issue and increases the risks and this has meant that many banks have decided to stay out of the business. What is needed is to provide banks access to processing, network, relationship, interoperability, and compliance, thus making it simple and cost efficient for them to offer this service to their customers. This is what companies such as Western Union, MoneyGram and Eurogiro do, and over the years, we have seen the emergence of numerous companies with a variation of services and products.

Although SEPA is the current industry focus, we already have seen many examples of the above global trend to make global low value payments more efficient. As financial institutions seek cost efficiencies, key words for the future will be interoperability, global reach, multiple product coverage (credit, debit and remittances), outsourcing (processors and facilitators), and a cost rather than income focus. The process will be partly driven by an internal drive for cost efficiency and by external pressure from the market for lower fees. So in the end, the process may be beneficial to all: the financial institutions, the customers and the companies specialising in offering these services.

Henrik Parl, managing director, Eurogiro Network A/S

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**Figure 1: Services in the value chain**

![Diagram of services in the value chain](https://example.com/diagram.png)
Releasing untapped value

In this article, Marcus Hughes of Bottomline Technologies explores practical ways of enabling large corporate clients to significantly streamline the processing of paper and electronic invoices within the accounts payable function.

This approach can generate significant working capital benefits for both buyers and suppliers, positioning firms to capture early payment discounts. In a highly process-oriented, risk-averse financial environment, where invoices are matched against purchase orders and goods received notes in an accurate and timely manner, specialist financiers and banks have also recognised an opportunity to provide supply chain financing as a source of new business.

Although web-based technologies supporting e-invoicing have been available for a decade, more than 85% of invoices are still printed on paper and distributed by post. Whilst there are some notable exceptions, it can be challenging for a buyer to impose on all of its suppliers a standard format electronic invoice, since each supplier will have its own way of processing outbound invoices. A more practical approach is needed to resolve this road-block on the migration to AP automation.

Taking the first step

Recognising the ongoing prevalence of paper-based invoicing, corporate clients are adopting a more evolutionary approach to invoice management as they migrate towards fully-fledged forms of e-commerce. Under this pragmatic model, inbound paper invoices are scanned, data is extracted, validated and matched before being routed electronically for approval in an efficient and timely manner. Such a solution can be structured in-house or outsourced to a specialist provider with the scale and experience to master advanced paper handling techniques, data capture and matching processes. With CFOs under pressure to reduce costs and improve working capital, outsourced invoice management services can provide a low risk way to achieve these targets.

Today, with more efficient systems for handling paper invoices and resolving anomalies, processing times can be reduced from days to just a few hours. The solutions that stand out are those which can successfully handle both paper and electronic invoices. The powerful barrier hindering the growth of the e-invoicing market is getting suppliers on board. However, on-boarding for suppliers can be as simple as asking them to redirect their invoices in any format, whether paper, PDF or e-invoice, to an experienced invoice management solution provider who will take care of converting paper documents into electronic formats, capturing and normalising the data to suit the requirements of the payer.

Capture the discount

Too many corporate clients are missing an opportunity to reduce the cost of goods due to their inability to capture early payment discounts on supplier invoices. This is because their accounts payable processes do not currently allow them to quickly identify invoices where discounts are available and approve them in time to capture the discount.

Businesses have long recognised that “cash is king.” For a small business with cash flow problems, an invoice issued to a large corporate payable in 30 or 60 days time can be small comfort. That is why many businesses of all sizes offer early payment discounts to encourage customers to settle trade debts early.

In an open account relationship, probably the most widely used trade term is “20/10 net 30”. This means that if a trade debtor pays an invoice within 10 days of the issue date, he can deduct a 2% discount and pay 98% of the face value of the invoice, resulting in a reduction in cost of goods. This discount equates to a massive annualised interest rate of 36% per annum, assuming these invoices are paid on the tenth day, but serves as a powerful reminder of the high value a business places on getting paid quickly and improving its cash flow.

Since few financial managers today can find a safe investment offering a return of 36% per annum, it is easy to see that taking advantage of early payment discounts can be good use of a business’ valuable cash resources. But the fact remains that many AP departments are not structured to take advantage of these favourable terms, since it typically takes more than 10 days to process and approve an invoice for payment using traditional methods.

With automated invoice management, invoice data can be validated and matched to a corporate client’s ERP within a few hours of receipt. The payer can capture early payment discounts and the supplier gets paid within 10 days, with significant cash flow benefits. Even in those situations where suppliers are not offering early payment discounts, efficient invoice management capabilities position a corporation to negotiate dynamic discounting with its supply chain. So much so that Gartner is predicting that by 2009, at least 30% of the global 2000 will have adopted dynamic early payment discounts as a standard practice in AP.

Working capital management gets collaborative

Naturally, one drawback of early payment for corporate clients is having to use their cash to capture the discount benefit. A collaborative enhancement of this model is to work with a financier who bridges the funding gap in order to solve that
age-old timing conflict between buyer and supplier, whereby the buyer wishes to delay invoice payment as long as possible, while the supplier wishes to get paid as soon as possible.

Specialist financiers have been among the first to participate in this structured financing opportunity. The combination of web-based technologies and supportive financiers is enabling suppliers to get paid early without using the cash of the payer to make early payments. At the maturity of the invoice, the financier’s advance is reimbursed by the payer.

There is a range of financing options, including non-recourse finance, which achieves a valuable off-balance sheet source of funds for the supplier. This is possible with the payer’s full agreement, where the invoice management solution has already achieved a successful match against a purchase order (PO) and, ideally, a goods received note (GRN).

The matching of these vital elements to a trade transaction enables financiers to reduce risk in making an advance, since there is a high degree of confidence that goods being financed have been ordered and received by the payer. This greatly increases the likelihood that the payer will in due course pay for the goods.

In a trade model where the supplier is a small- to-mid-sized enterprise (SME) and the buyer is a large organisation, such as a commercial paper, there is an opportunity for interest arbitrage between the credit quality of the payer and the supplier in which all parties to the transaction can benefit. The financier, having reduced the risk of non payment of the invoice through automated matching against a PO and GRN, can afford to offer competitive rates of interest to the supplier for early payment of the invoice.

This would typically be financed at a rate of interest lower than the supplier might normally achieve on early payment discounts, factoring facilities or overdrafts. This structure reduces the cost of funds for participating SMEs and enables them to free up working capital faster. This “belt and braces” approach of using valuable trade data from both the buyer and the supplier enables the financier to minimise the risk of fraud, a longstanding problem in conventional factoring where more than one supplier has been known to present false invoices and request finance.

It will also not have escaped the thinking of specialist trade financiers that under the new Basel II requirements, structured lending facilities, which achieve a high degree of transactional control and make use of techniques such as credit risk transfer, qualify for lower capital reserve requirements than unstructured credit facilities to lower credit quality borrowers, such as SMEs. As a result, by transferring risk to large payers with strong credit ratings at the top of supply chains, the financier can achieve a lower Basel II capital requirement.

Extending trade credit terms for payers
In some cases, financiers are allowing payers to extend their trade credit terms. Under this model, the supplier gets paid by the financier within a few days of invoice approval, but the payer is allowed to delay settlement of the invoice until a later date, thereby achieving, for example, 30 days additional credit. This is effectively a reward for giving the financier visibility into the approved invoices so that the financier can offer early payment finance to suppliers.

Offsetting the impact of payment regulation
Given the availability of web-based technologies and invoice management services capable of processing these transactions on a large scale, the door is now open for commercial banks and trade finance banks to adopt this structured finance approach. This new source of revenue could prove particularly attractive to banks at the current time when they are in search of value added services to shore up their revenue streams from other more traditional areas.

The new regulations on EU payments and the infrastructure investment required to comply with the Single Euro Payment Area initiatives, for example, are resulting in significantly lower profitability forecasts for many EU banks in payments and cash management. So it may prove good timing that just as forward-thinking banks are tending to combine cash management and trade finance lines of business, they are now better positioned to exploit the arrival of purchase-to-pay solutions on a scalable basis through white-labelling partnerships with service providers.

While end-to-end electronic invoicing remains some time away, for now, successful invoice automation initiatives are proving to be those capable of handling both paper and electronic invoices in an evolutionary fashion. Recently, a handful of pilots have been launched using structured supply chain finance models. To date, these have been hindered by the shortage of electronic invoice workflow, and thus the difficulties inherent in trying to match invoices manually in a time frame to allow for capturing early payment discounts.

This challenge can now be solved through the combination of an accurate and timely paper and electronic invoice management solution and innovative financiers ready to help buyers and suppliers extract maximum value from the financial supply chain, with bottom line benefits for all participants.

Marcus Hughes is head of Banking for Bottomline Technologies Europe

“In a trade model where the supplier is a small-to-mid-sized enterprise and the buyer is a large organisation with a high credit rating, there is an opportunity for interest arbitrage between the credit quality of the payer and the supplier in which all parties to the transaction can benefit.”
Country Focus: Bulgaria

Bulgaria is in South-eastern Europe and borders the Black Sea between Romania and Turkey. It is a former communist country and up until 1989, it was ruled by the Bulgarian Communist Party, which has now been renamed the Bulgarian Socialist Party and remains a part of the coalition government. The first free elections took place in 1990 and in July 1991, a new constitution was adopted. However, a major economic downturn in 1996 as a result of the country’s difficult transition to capitalism, caused the fall of the socialist government and the opposition Union of Democratic Forces took over. In reaction to these problems, which included an unstable and decapitalised banking system, the UDF’s focus turned to economic reform and responsible fiscal planning. This in turn, paved the way for discussions about Bulgaria’s entrance into the European Union, which is finally scheduled to happen in 2007.

Currently, the economy is performing well as it is growing at a steady pace of around 5% a year and the country has moved rapidly towards the Maastricht Criteria on nominal convergence. This progress was facilitated by the foundation work of the government and its imposition of a fixed exchange rate of the Bulgarian lev against the German deutschemark in 1997 and the negotiation of an International Monetary Fund standby agreement.

This 14-month standby agreement expired in June 1998 and the government and the IMF reached a longer term agreement in July 1998 on a three year loan worth about US$800 million. This loan has been used to drive the economic reform process forward, which after 2001, focused on moving towards EU accession. However, it was not until 25 April 2005 that Bulgaria signed the Treaty of Accession.

Low inflation and steady progress on structural reforms have improved the business environment. Bulgaria has averaged 4% growth since 2000 and has begun to attract significant amounts of foreign direct investment. The annual year-on-year GDP growth for 2006 is expected to total 6.0%.

The Bulgarian National Bank (BNB) has therefore evidently been successful at working on maintaining price stability by ensuring national currency stability. The European Commission’s 2002 regular report on the progress towards accession highlighted the status of Bulgaria as a functioning market economy but stressed that competitive pressures are likely to increase over time as a result. The impending EU accession target date has therefore led the BNB to focus on the issue of competitiveness in the Bulgarian economy. Accordingly, the National Economic Development Plan 2000-2006 identifies this as a number one priority which needs to be monitored closely.

To this end, the BNB has focused on issuing activities, managing international reserves, servicing cash circulation, organising and overseeing payment systems, and regulating and supervising banks in the country as prescribed in the Law on the BNB. With regards to payment system oversight, the BNB’s role is defined by the legislation: “The BNB shall be responsible for the compatibility and unified functioning of the payment systems in the country.”

The central bank’s issuing activity is governed by the currency board principle which stipulates that the bank exchanges national currency only against foreign currency at the rate set by law. This was previously pegged to the deutschemark and was later changed to the euro.

In early 2005 the National Assembly adopted some amendments to the BNB’s operating practices. According to these amendments the central bank’s major objective is to maintain price stability in accordance with the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB). Maintaining price stability is connected with ensuring the stability of the national currency, as a reflection of the currency board specifics.

The World Bank has praised the progress that the Bulgarian economy has made over the last five years and in its report, Bulgaria: The Road to Successful EU Integration, which was published in November 2005. The report underlines this...
achieve: “Over the last seven years Bulgaria has made impressive progress towards long-term stability and sustained growth. As a result of sound macroeconomic policies and deep structural reforms, average growth has reached the levels of eight European Union new member states (NMS8).”

There are still concerns about the resilience of Bulgaria’s economy and according to another report released in January this year, despite the economic progress that has been made, it remains far below the European average. “Although Bulgaria exceeds Romania, it lags far behind Hungary and the Czech Republic. The Bulgarian economy as a whole is extremely vulnerable to shocks, particularly those coming from the Eurozone” said the report, which was commissioned by President Georgy Parvanov.

The World Bank’s 2005 report also acknowledges these shortcomings: “The country’s per capita income, at PPP in 2003, was 31 and 56 percent of the average level of EU25 and NMS8 countries, respectively. Given Bulgaria’s large income gap with EU25, improving the efficiency of the economy is necessary to ensure that forthcoming EU accession will rapidly narrow the gap and result in sustained improvements in living standards.”

In order to bring Bulgaria into line with these countries, the report recommends that the government should focus on increasing employment and productivity, as well as reducing regulatory complexity and effectiveness. Macroeconomic stability is essential in order for the government to effectively work towards these goals: “The reform agenda needs to be supported by macroeconomic policies that address the risks and vulnerabilities, and make progress towards monetary integration.”

BNB and legal foundations

The BNB’s role is therefore central to the country’s economic wellbeing and this role is clarified under the Law on the BNB and updated by various related laws that have been passed since. One such piece of legislation is the Law on Funds Transfers, Electronic Payment Instruments and Payment Systems, which came into force on 8 October 2005 and responds to the government’s goal of regulatory harmonisation in the electronic payments space.

This government priority is explicitly stated in its strategy for accelerating Bulgaria’s negotiations for accession to the European Union: “As a matter of priority, BNB must transpose the requirements concerning gross settlement systems in real time. Projects are developed for amendments to the legal framework concerning the introduction of a real-time gross settlement system.”

The 2005 electronic payments regulation deals directly with this requirement and governs:
• the execution of domestic transfers;
• the execution of cross border transfers;
• the issuance and use of electronic payment instruments;
• the establishment and operation of payment systems;
• payment systems oversight; and
• procedures for the out-of-court settlement of disputes in relation to the execution of transfers or the issuance and use of electronic payment instruments.

This law achieves full compliance with the EU Directives on cross-border credit transfers and on settlement finality, and also with the recommendation on electronic payment instruments.

According to the electronic payments law, the oversight of the BNB covers systems operators, participants in these systems, including performing institutions, intermediary institutions, issuers of electronic payment instruments and all other persons related to the functioning of the systems, and payment mechanisms for corporate and government securities. In this endeavour the BNB is authorised to undertake on-site examination and demand that all participants provide the required documents and information on their activities.

After the signing of the Treaty of Accession, the BNB obtained observer status in the ESCB, which gave the governor of the bank the right to take part in the meetings of the ECB General Council and the BNB experts the option to participate in the ESCB committees. At the same time, the central bank also drafted its strategy for the BNB development in the period 2004 – 2009, which deals with the country’s accession strategy.

Furthermore, the 2005 Law on Amendments to the Law on the BNB introduced additional guarantees for the institutional, personal, financial and functional independence of the central bank in compliance with the treaty establishing the EU and the statutes of the ESCB and the ECB. The other amendments introduced by this law regard the BNB’s functions related to the surveillance of payments systems, the security of banknotes and coins against counterfeiting, and the central bank’s internal audit. The amendments also fully ban any financing provided by the central bank to the government.

The BNB is the governing authority that has the ability to grant licenses to permit institutions to function as payment system operators. These institutions must meet certain requirements in order to be granted permission, including being established as a joint stock company with a seat in Bulgaria and having a minimum subscribed capital of at least Lv5 million. There is also a prescribed minimum level of education and training for the members of the management of the system. The BNB may revoke a license in the event of any serious violations in terms of operation and may issue written warnings prior to this action.

Following a series of measures in 2004, the BNB extended the range of liabilities to be included in the calculation of the minimum capital required reserves to be held at the central bank for the most aggressive lenders, in April 2005. This piece of regulation left the minimum reserves at 8% of the deposit base, but ceased acknowledging banks’ cash reserves as reserve assets, as well as extending the range of liabilities.

Two additional thresholds were introduced dealing with loan growth over a certain figure and the sum of extended loans and risk weighted off-balance sheet items converted into balance sheet assets, less banks’ own funds if they exceed 60% of the funds that the banks have attracted. Over these thresholds, banks are required to deposit double the amount of excess over the quarterly lending growth.

The operations of commercial banks are defined and regulated by the 1997 Law on Banks, which also provides for the establishment of new banks and the penalisation of these institutions. This law also regulates the operation of foreign credit institutions. Bank customers are protected by the Law on Bank Deposit Guaranty.

As of January 2006, there were 28 Bulgarian banks and six branches of foreign banks registered by the BNB to operate in the country. At the end of January, the total assets in the banking
The introduction of RINGS necessitated some amendments to the regulatory framework governing the country’s payment systems. The Electronic Trade and Electronic Signature Law came into effect on 7 October 2001. In August 2002, BNB Regulation Number 3 on Payments was fully amended, and now its name is Ordinance Number 3 on Non-cash Payments and the National Payment System. Other regulations were also amended, including Ordinance Number 16 on the Payments with Bank Cards providing for the transactions associated with the national card operator BORICA.

Moreover, the RINGS Rules and Procedures, and the Guidelines on the Operation of the System Operators were also adopted: the Operating Rules of BISERA, the Guidelines on Payments by Bank Cards, and the Instructions issued by the BNB and the Central Depository AD on the Payments Effected under Book-entry Securities Transactions were all altered accordingly. All these systems now have interfaces with RINGS in order to enable them to send settlement requests. The Government Securities Settlement system has a real-time interface with the system.

RINGS

RINGS performs irrevocable and unconditional settlement of all payments in Bulgarian lev within the country. The settlement agent is the BNB and accordingly, the central bank sets up, organises, regulates, controls, operates, administers, supports, develops, and oversees RINGS. It also owns RINGS and determines the rules for participation in the system and the contingency arrangements. Through settlement at the BNB, the liabilities originating from the transfer of funds and securities transactions payments are settled with finality.

In order to participate in RINGS, applicants must set up settlement accounts at the BNB. Banks must be licensed institutions and system operators must be authorised by the BNB board of management. Each participant has equal right to access the system within its hours of operation as specified in the RINGS rules and procedures. The commercial bank participants must keep a covering balance on their accounts that is sufficient to settle all of their payment instructions.

Figure 1: Volume of payment instructions handled by RINGS over 2005 by time band
In June 2005, the number of RINGS participant banks decreased to 35 as a result of the exclusion of the International Bank for Trade and Development. Despite the revocation of the bank's license last year, there appeared to be no adverse consequences for the banking community or the payments process. RINGS will only handle payment instructions that are denominated in Bulgarian lev but it will accept payments up to any amount. The payments that are accepted by the system are:

- payments between commercial banks and payments at the express order of a commercial bank’s client;
- all client and budget payments, as well as payment orders on cash collection requests equal to or exceeding Lv100,000;
- payments on settlement requests submitted by system operators;
- payments between the BNB and a commercial bank;
- payments on transactions in government securities;
- payments associated with the self-initiated collection of fees, interest and commission charges by the BNB;
- payment on execution levied against accounts of commercial banks; and
- settlement requests on payments of government budget spending units submitted by the BNB General Accounting Directorate.

In order to ensure the smooth functioning of RINGS, the BNB has developed mechanisms to cover liquidity needs, including a reserve guarantee fund. Participants in the system must sign contracts with the central bank before they can access this fund. Each RINGS participant is under an obligation to notify the BNB immediately in the event of an actual or potential occurrence of liquidity difficulties. At this time, they must also indicate the steps that they have taken to overcome the problem.

Furthermore, the system allows for three priority levels to be set for a payment: ‘low’, ‘high’ and ‘systemic’ priority. The low priority is applied to payment orders initiated by banks and this category is also used for all payments that have not already been set another priority. High priority is only actively assigned by banks, although it is automatically applied to all payments from banks to the BNB.

The systemic priority payment category is limited to payments on BNB-initiated collections of amounts from settlement accounts and on settlement requests submitted by the system operators. There is a hierarchy within this category that means that the former type of payment is settled first.

The BNB is able to alter the RINGS operating schedule at any time and it publishes the updated timetables at least once a year. RINGS uses the Swift network and the Swift FIN V-Copy service for the interbank flow of payment messages. If the funds held on the settlement account of the payer are insufficient, the payment order is queued and the payer is able to alter the priorities of the payments in a queue at this time. If they are not prioritised, the system settles them on the first in, first out principle. However, if these payments have not been settled by the end of the day, RINGS returns them. Therefore, the payer sends a payment order to the receiving bank via Swift for settlement in the system, which is then intercepted by Swift FIN Copy and converted into a settlement request. The original message remains queued in Swift until it receives either a confirmation of settlement or a message that the payment has been refused, which is then transmitted to the participant.

The BNB ensures the acceptance, verification and validation of payment orders and settlement requests, in which the participants are identified by their Bank Identifier Codes. The central bank also provides for the accurate recording of accounting operations performed on the participants’ settlement accounts and the generation of account statements and relevant information for these participants.

Gridlock resolution procedures are in place to deal with the event that two or more queues of pending payments are blocked. An automatic mechanism for resolution is invoked if it is possible to execute the settlement of all pending payments or all those prioritised as high or systemic priority. Participants are notified of the gridlock by the BNB via an MT298 message.
The gridlock can also be dealt with manually if no partial unblocking of the queues is possible.

There are contingency measures in order to deal with the occurrence of technical problems in the system, including a back-up system. The BNB is then tasked with the job of restarting RINGS operation on the first business day after the repair of the problem. System participants are also obligated to inform the BNB immediately upon the occurrence of any problems that may lead to increased operational risk.

According to the 2005 BNB report on payment systems in Bulgaria, 70% of the amount of effected payments in the country were processed by the RINGS system. However, these payments only comprised 0.62% of the total number of payments processed in Bulgaria. Between 1 January and 31 December last year, RINGS payments numbered 782,736 at a total of Ltv163,830 million.

In terms of daily average payments, RINGS experienced an increase of 41.5% on 2004 average volume and an increase of 30.4% on average value. This highlights the growing number of non-cash payments that are being processed by the system and, in order to cope with the rising level of risk that this entails, the BNB has been actively encouraging payments earlier in the processing day. Accordingly, over the first half of 2005, 48.5% of payments were processed by noon and 75.8% by 2.30pm.

If payments are processed earlier in the day the risk of payments not being effected by the end of the day is substantially reduced. The busiest time in the system over that period was the morning, as 92.1% of RINGS payments were effected by 2.30pm. Participant behaviour also lowered risk over the first half of last year as no payments were rejected due to insufficient funds. New system software was implemented over 2005 in order to improve the operation and facilities of RINGS. The system offered 99.71% availability over the year.

The BNB is focusing on bringing RINGS into line with TARGET2 operating practices with a view to integration after Bulgaria's accession to the Eurozone. RINGS therefore provides technical possibilities for processing payments in euros and executing international payments.

Figure 4: Value of payments in 2005 by system

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Depository</td>
<td>25.88%</td>
</tr>
<tr>
<td>BORICA</td>
<td>0.64%</td>
</tr>
<tr>
<td>RINGS</td>
<td>2.63%</td>
</tr>
<tr>
<td>BISERA</td>
<td>70.85%</td>
</tr>
</tbody>
</table>

Bulgaria's accession to the Eurozone. RINGS therefore provides technical possibilities for processing payments in euros and executing international payments.
With over 10 years of experience in working with US ACH systems you must be well-versed in the key challenges of the industry — now that Check 21 has been implemented, what is the next big challenge for the market?

This is a great question. In terms of the growth of the US ACH and after the roll-out of Check 21, the next biggest challenge is risk management and safety and soundness in the market. I think that as cheque writing comes down from both the consumer and the business perspective, fraud also begins to move from traditional paper fraud into the electronic world. The ability for the industry to come together and create better risk management protocols and creating more safety and soundness in the industry are important tenets that I would point out are the next big challenges for the industry.

Another challenge will be scheme consolidation. Every time something new comes out we develop a new scheme, or as they say in the US, a new ‘rail’ for payments. So now you have a very well run ACH application that pumps through something to the tune of 14-15 billion transactions, of which JPMorgan originated 3.4 billion last year. And now you have a Check 21 scheme that is taking traditional paper cheques and imaging them. One of the next big opportunities in the market is to consolidate those two schemes together so cheques can still be issued and truncated on a Check 21 scheme and perhaps even settled on an ACH. I think there are moves in the industry right now to begin those dialogues. It would be a win-win for all of the customers, both the consumers and the businesses, because you are leveraging a known and trusted payment system: the ACH. The focus is on the future.

So my headlines are: one, the safety and soundness of the industry, and the second is consolidation.

Globally, I think that outsourcing is likely to grow in the market over the next few years. At the end of the day, a payment’s a payment. But adding value around the speed and the security of a payment provides attractive features to both consumers and businesses, and that is something that we continually focus on. We realise that within the core payments market, regardless of where you are operating, the payment looks the same. It is how that payment is settled, the systems you use to settle and the information reporting around the payment, especially for corporates by attaching that key invoicing data, that makes the difference. The ability to provide these services straight-through is where the value is. Anyone can make a payment but it is the ability to provide a matching service that adds value.

What have been the key growth areas and drivers for growth in the payments market over the last decade?

The first thing I would point to is the internet. The internet has
provided both consumers and businesses the opportunity to be able to consolidate and, in some cases, better manage their bill payments and their receivables in payments. 10 years ago for example, a consumer received a paper statement. They would more or less have to write a cheque, put that cheque in the mail and send it back.

Credit card companies and telecoms companies today all offer robust bill payment functionality via the web. A consumer can log on and be presented with their bill, they can authorise a monthly recurring direct debit, or they could make payments multiple times throughout a billing period. So it has offered the opportunity for, number one: reduced reliance on paper cheque writing. It has also offered the opportunity for reduced reliance on cash payments, which are typically high risk and high cost. And it has offered consumers and businesses the opportunity to make more frequent payments.

There is an analysis by a major credit card company in the US that indicated that consumers today make far more payments than they did five years ago. Because of the freedom the internet brings, they are able to log onto the internet and pay at will.

There has also been an explosion in third party payment providers in the market that are offering unique and value added services to consumers and businesses, as well to drive additional electronic payments.

The advent and the growth of home banking is another important trend, at least for the consumer segment of the industry.

Could you explain what has driven the growth of the accounts receivable cheque conversion market?

Before I was at JPMorgan I ran payment services for American Express and I rolled out the first major ARC program in the US. From a corporate perspective, we were one of the most significant lobbyists in the industry to allow cheque conversion, which is very different from Check 21. It is the ability to take a consumer paper cheque, convert it to an ACH transaction and settle it on the ACH rail. There has been absolutely significant growth in this industry: from zero payments in 2001 to over a billion by the end of 2008, and it’s continued to grow from there. It is the fastest growing ACH standard entry class code ever created.

Why? Consumers don’t actually opt for this; Businesses make a decision to do this with their payments in order to significantly lower their back office processing costs in a couple of different ways. One is it reduces transportation costs – they don’t have to truck cheques around any more, they can process and destroy the cheque within 14 days. It also reduces their cheque clearing costs – cheques cost more to clear than electronic payments do.

In addition to treasury expense savings, the opportunity to reduce risk and fraud losses is also compelling. For example, a major nationwide biller in the US that rolled out cheque conversion experienced a US$12 million reduction in both operations and risk losses. It is really significant. When you take the cheque out of the mix, it means reduced fraud because ACH returns come back much quicker so that companies can manage the return much faster and deny service. Essentially this means a five to seven day bump in reduced cycle time, and that is one of the key reasons for adoption.

Could you explain the benefits that Check 21 has brought to the industry?

First and foremost, Check 21 had been a strong concept in the industry, but the unfortunate events of 9/11 quickened the pace for the Congress to pass this bill. There were a number of reasons for this and one was that when planes don’t fly, cheques don’t fly. Cheques have a great life because, when you have a high value cheque, it flies on a private jet from coast to coast. Check 21 reduces payment system risk in the industry, and the Federal Reserve and Greenspan were completely behind that.

Reduced fraud and reduced cost of transportation have also been benefits. Physical cheques that don’t ride around in trucks can’t be stolen. Once they have been imaged, they can’t be lost. It also provides more straight through processing within the system. Check 21 didn’t mandate the use of the image but it allowed the use of a substitute cheque. So banks that can do it are enabled, but banks that can’t accept imaging are getting paper – it works in everyone’s favour.

What has been/will be the impact of Check 21 on ARC volumes?

We never looked at it as a battle between Check 21 and ARC because ARC is transitional. It was never meant to be a product that lasts – at some point, cheque writing in the US will become more like a premium service. More and more consumers are moving from cheques to electronic payments; cheque usage is currently dropping between 6-7% a year in the US. As cheque writing falls naturally, customers are moving organically to mechanisms such as ACH. ARC volumes will therefore inevitably go down because you can’t convert what you don’t receive.

Check 21 is a great companion to ARC because it provides efficiencies in the market and it also provides risk reduction. At a certain point, banks would be foolish to think that ARC volumes will go up forever. We predict that between 2007 and 2008 these volumes will begin to flatten out and then go into a steady state of decline as cheque writing continues to fall dramatically in the consumer segment.

On the corporate side, the only negative I could identify would be potential issues with quality. When you begin to truncate cheques from a Check 21 perspective, you must take the physical cheque out of the mix. The big risk in the industry is that you produce an image file but you also submit the cheque. There is the danger of double posting if the process is not managed well. From a quality perspective, that has to be monitored very closely.

How has the ACH industry combated fraud in spite of the growth in volumes?

The ACH industry was created over 30 years ago as a community based on trust. If you looked at the types of transactions that first went through the ACH, they were the safest kinds of transactions: payroll. The second was the insurance industry as a huge driver in the ability to collect premium payments for insurance policies. As the ACH has grown, we have grown to other types of payment – bill payments, B2B payments, C2C payments – and as this has grown, fraud has popped up. It is up to every financial institution that uses the ACH in any market to know their customer and it starts there. You have to know your customer and know what the payments are for. Not only are you protecting your own financial institution, you are protecting the network and the entire payment system.

Although fraud has gone up, it is a mere fraction of what it is in the credit card, debit card and cheque industry. I think the
challenge is now to keep it down as the payments landscape continues to change. There are a number of industry bodies involved in working towards this, including the Federal Reserve, Nacha and the Electronic Payments Network. They all work very closely together in combating fraud.

What can Europe learn from the US market in the payments arena?

Standards. Until things are common and standard, we’re not going to get anywhere. I know that we are in an interesting place right now in Europe as the landscape begins to change, but I apply my thinking to looking at the ACH in the US 20 years ago. At that time there were many clearing houses and there were different states with different rules. As the consolidation occurred, bilateral agreements came up and today there are only two clearing houses in the US. Behing this transition is that there is one rule book, there is one set of standards and there is accountability so that all those banks have to play nicely together.

I look at the 25 euro states the same way. We’ve got differing needs, politics and consumer requirements, so it is going to take us working together to find out what these standards are and once they are developed, building towards that critical mass. It is going to take some time but I know that we’re going to get there. I’m very confident that every European citizen is going to have the opportunity to make what is known as a cross-border payment today into a domestic payment tomorrow. We are in the middle of it at the moment and I think that the work that the EBA, the ECB and the EPC are all doing is overall positive, but I just think that it could go a little bit faster.

I think there are some challenges to SEPA’s 2008 deadline. We’ve already hit 2006 and this change from our perspective represents an even more significant change than that of the currency change in 1999. I think that we have to take some accountability here and get behind some real structured work in order to move this forward. I think overall my tone is positive but getting there is the challenge, the struggle is that the roadmap is not that clear. There is still some confusion in the industry in terms of what are those rules for European direct debit or for European ACH? Is there enough addenda record information? You can go on and on, but at some point we have got to say ‘OK guys the book is closed, we need to move on’. We need to move towards critical mass.

Will market forces alone drive consolidation of all of these ACHs? Because if they don’t consolidate, the true benefits to the industry won’t be there or be as effective.

Conversely, what can the US learn from the rest of the world?

To move away from paper as fast as it can. The US has had such a long love affair with paper and although it is coming down fast, it is not coming down fast enough for business to business payments. The only thing that stops a business from going fully electronic is a lack of capability and value offered to them. They can also learn something from the European corporates and financial institutions, as well in terms of offering those types of benefits. It may even be further adoption of Swift in the US that will provide that catalyst for change.

What was behind the decision to move the headquarters for JPMorgan’s international ACH division from New York to London?

From my perspective it was a concern about managing a global business. I felt we would be more suited to being headquartered in London for global mass payments versus in New York. The other is that when you are in New York, you are not in the global market and it becomes very US-focused. I’ve always had international staff but I think there is nothing like being there. It adds credibility to our business as a global bank – we are not just a US dollar bank, we are committed and making significant investments in global markets from a treasury services, core cash management perspective.

“‘The cost of compliance continues to go up and it is an issue for all of us. At the end of the day, everyone pays.’”

Could you explain the work you have been involved in over the last year?

I manage both our global mass payments and our in-country treasury services businesses in 78 countries around the world, from a high value and a paper perspective. We have been focusing on being the world’s global and local provider, building out capabilities in markets. We are very proud of the fact that we opened our branch in Ho Chi Minh City in Vietnam last year. We have continued to expand our ACH offerings around the world – we are currently in 27 countries for payments and 18 countries for direct debits. We continue to build value around those mass payment services. On top of that we are also working very closely with the industry on SEPA, changes in Asia and looking at risk management and regulations that we have to abide by.

What will you be focusing on over the next year?

Investments in the new payment landscape in Europe. We are building out a new global operating model for our euro processing and we are also making some heavy investments in Asia. We are building a web-based Asia receivables application. We are also looking at some opportunities in South America, in terms of re-entering some of the markets and enhancing our service offering in Mexico, as well as looking at opening up some additional markets for core cash management.

I think that part of this is a focus on education from a financial institution perspective. As you grow new payment channels, you need to make sure that your clients are educated about how to use them and also on the changes. Recently we hosted a corporate forum for a number of clients to do just that and we received really good feedback. Education is an important part of what we’re going to do in the next year as well as investing in our business.

Related to this, what are the key trends in the European and Asian markets that you will be monitoring over the next year?

The cost of compliance continues to go up and it is an issue for all of us. At the end of the day, everyone pays. But it is important and we need to put in the effort.
CB.Net Ltd

CB.Net is dedicated to the delivery of reference data solutions to the global banking community. We recognise the importance of reliable reference data in being a major contributor to cost savings and greater efficiency in international payments and compliance requirements. Our flagship product BankSearchPlus is the definitive international payments directory, providing access to critical international payment data in one source. BankSearchPlus contains over 90,000 Standard Settlement Instructions (SSIs) linked to all BICs with national clearing codes for over 80 countries. Other BankSearchPlus components include IBAN2BIC which validates and links IBANs to the issuing banks; and BIC history. BankSearchPlus offers institutions a complete payments tool.

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BT Radianz is the leading provider of secure, reliable, and scalable connectivity to the global financial services community. BT Radianz’s shared market infrastructure offers a content- and application-neutral platform optimized for the time-critical demands unique to financial services. The BT Radianz network connects over 10,000 financial sites around the world through a single, redundant, fully-managed connection – while also providing access to more than 150 pre-trade, trade, and post-trade applications from the world’s leading content and service providers, across the straight-through processing (STP) chain. BT Radianz. One Community. One Connection. One Focus.

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Temenos is a premier provider of integrated modular and core banking systems to over 300 financial institutions worldwide. Live in over 500 sites and 100 different countries, TEMENOS software provides banks with a single, real-time view of the client across the enterprise, enabling banks to maximize returns while streamlining costs. Whether providing 24/7 functionality to the wholesale, retail and private banking sectors or partnering with central banks on core system replacement, TEMENOS understands your requirements and knows banking. TEMENOS has 34 offices in 29 countries and is listed on the main segment of the SWX Swiss Exchange.
We keep our eye on the radar to make sure you stay on course

T.K. Yim flies planes. He also pilots BT Radianz's Customer Service and Operations team in Asia. Both require intensive planning, precision and maintaining a constant watch on the control panel. T.K. and the entire team at BT Radianz are experts at this.

BT Radianz provides monitoring and proactive management of your connectivity to identify and solve problems before you even know they exist. That's the benefit of having operations staff with advanced networking skills and a unique knowledge of financial services technology.

We change course so you don't have to. And we never leave you up in the air.

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