

THE VALUE OF AUTOMATION IN PAYMENTS EXCEPTIONS AND INVESTIGATIONS

This article considers the current pain points when it comes to payments exceptions and investigations, and the latest initiatives to combat the problem including SWIFT's solution to this industry challenge.

Introduction

Industry figures indicate that 2-5% of all payments give rise to an exception. While this might seem like an inconsequential proportion of overall payments volume, it represents a growing cost and pain point for all players in the industry - corporates, banks and financial institutions. It is therefore vital for the industry as a whole to address this issue by targeting the trigger points of payments investigation, as well as applying technology to common exception types in order to resolve payments investigations in a fully automated way.

Drivers for Automation

The increased awareness of operational risk and the escalating costs of managing investigations are driving industry players to improve operational efficiencies through the use of automation. If a transaction is settled automatically and handled straight through, the entire process costs, on average, just a few cents. If, however, it fails and leads to non-settlement - with a manual process initiated to tackle the investigation - it can cost up to US\$100. And this figure doesn't even include the follow-up cost of the non-settlement of a transaction. Financial losses include principal losses when incorrectly paid funds are not retrieved, penalties and compensation costs associated with settlement errors, and the operational costs



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incurred in processing exceptions (for example, overtime, inflated staffing levels and contractor fees).

Furthermore, as a result of the introduction of the single euro payments area (SEPA), the cost of exceptions and investigations has become even more detrimental for European banks and financial institutions because this pan-European initiative has considerably reduced the traditional income these players made from payments processing.

Payments exceptions and investigations can also cause reputational loss to occur between a financial institution and its direct customers, correspondents or various regulatory agencies. In these cases, profitability is jeopardised through the erosion of business opportunities and a loyal customer base. It is these factors - increased costs and the damage caused by reputational loss and operational risk - that are driving forward industry initiatives to help automate and improve efficiencies around payments exceptions and investigations.

Exceptions & Investigations: The Stumbling Blocks

Investigations are traditionally a post-settlement event where the responsibility lies with the financial institutions involved in a transactions' lifecycle, and the focus is handling the investigation rather than considering what triggered it. In order to address this problem effectively, it is important that the industry examines more closely where and how the investigations occur in the first place.

In most cases, the trigger for a payments investigation is usually found at the corporate side and a high percentage of these are caused by requests for additional information as well as payment defaults. This leads to the situation where a bank has to deal with a payment that it doesn't have enough information to allocate correctly, which turns into a payable/receivable matching challenge. Investigations also occur when transactions are identified that cannot be dealt with appropriately because they weren't actually expected. These are the most commonly identified causes of exceptions and investigations and they are all related to the reconciliation process.

When we consider how automated the industry is today, we need to differentiate between the different players involved. Many high volume payment processing organisations, such as banks and financial institutions, have invested in the automation of the exception management process using market-available products. On the other hand, there is a sizable part of the market - and therefore the payments value chain - that isn't currently automated. A payment and, therefore, an exception are typically handled by two or three financial institutions and intermediaries along its lifecycle before it is settled. How automated all players within the lifecycle are is an important factor to consider, and when we consider the overall industry, the level of automation is actually extremely low.

The lack of standards in the payments industry has also fostered a highly manual environment for exceptions handling, as companies are not well equipped to communicate with one another or their customers. This lack of automation can also be attributed to an insufficient investment in technology. For instance, a multinational corporation will have a high payments volume across its organisation based on proprietary channels with each of its respective banking partners, which is seldom standardised making it difficult to automate the process across multiple payment channels. Our studies into the manual processes that take place during exception handling reveal that the majority of effort is spent on conducting research into the underlying systems for information around a particular transaction and taking appropriate actions once the position is understood.

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It is in this task that automation is most vitally needed, i.e. in extracting information out of the overall payments environment in order to automate the handling of an exception. Best-of-breed exception management solutions require highly structured incoming messages for automatic logging, business intelligence to trigger actions based upon that information, and online access to salient transaction history information. This is an area where SWIFT is taking great strides forward.

How is SWIFT Addressing the Problem?

The lack of automated exception management in the payments industry can be partially attributed to the lack of messaging standards. Today, institutions are most likely to use the MTN99, MTN95 or MTN96 free

format message or other messaging media without taking advantage of the efficiencies gained by the auto processing of standardised messages. As mentioned earlier, multiple intermediaries are involved along the lifecycle of a payment. Using the free format messages means that each entity might type in information in a slightly different way, which hinders the automated extraction of relevant information to deal with an investigation. Extracting keywords that can then be used for querying underlying systems for resolution information is one of the main advantages of SWIFT's XML-based Exceptions and Investigations (E&I) solution.

The launch of the SWIFTNet Exceptions and Investigations solution, commercially available since September 2007, supports the automation of payment-related enquiries for both financial institutions and corporates. The solution structures formats around the specific problems that a payment might encounter so all parties involved know exactly what information they will find in any given field and what format it needs to be in. It also provides a rulebook to support the automation of exceptions and investigations.

Another issue that SWIFT addresses is the frequent problem that occurs when there is an exception or investigation and the last intermediary in the chain contacts the first intermediary directly, thereby bypassing everybody else leaving them without an update on the status of the respective exception. SWIFTNet Exceptions & Investigations ensures that when there is an issue, everyone in the lifecycle is informed and knows what the status of the exception is.

SWIFT's solution provides the basis for automation of exceptions for the entire industry, but software and technology that help banks and corporates to automate the process and adhere to the rules that SWIFT has introduced turn the potential for automation into reality. Such products will

help facilitate the processing of exceptions information and research data within the workflow where necessary.

It is also important to note that the co-existence of different message types will remain a reality even if SWIFTNet Exceptions & Investigations penetrates the market because corporations and financial institutions will continue to send MTN95, 96 or 99 messages. Corporates and financial institutions will need to be able to identify who in their exceptions lifecycle is SWIFTNet Exceptions & Investigations-enabled and who isn't and adjust their systems accordingly. This might seem like a complex work-around but it is a challenge that many market-available products and solutions are able to alleviate to a great extent. From a SunGard perspective, for example, this is something we have addressed through the availability of different customer communication channels that can be adapted to suit the needs of a transaction's specific lifecycle.

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SunGard offers a solution, for instance, that handles payment exceptions, securities and confirmations across multiple instrument types. The product allows companies and banks to automate the management of payment exceptions that requires a communications layer and a general handling layer, based on a casebook that contains the relevant information about a particular transaction. The next step is to create correspondence around that exception in a highly automated way, which is based on our workflow engine that allows us to automate the process as much as possible.

Depending on the information that a corporate or financial institution has from an incoming or outgoing investigation, a decision

tree is accessed and the information is processed automatically through various stages including research in order to gain a consolidated picture of the problem. The basis for this is an end-to-end exception management processing capability.

As the new standards are embraced and both corporates and financial institutions leverage the solutions available, we should start to see significant automation in payments exceptions and investigations.

Benefits of Automation

An obvious benefit of automating the exceptions process is faster resolution time of exceptions. This reduces the cost of the exception handling itself as well as the follow-up cost for non-settlement. Clearly, the ideal situation is to prevent exceptions occurring in the first place, which needs consideration of

current post-settlement approaches specifically around reconciliation versus pre-settlement exception management. The ideal scenario will include pre-settlement matching to identify exceptions before they become a loss. This will allow exception management that targets failure prevention resulting in reduction of operational risk.

Conclusion

The combination of automated exception management solutions and the rulebook and standardisation around formats that SWIFT has implemented creates a best practice approach for the industry going forward. As the new standards are embraced and both corporates and financial institutions leverage the solutions available, we should start to see significant automation in payments exceptions and investigations.

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