

Faster Payments: Flexible platforms and fraud prevention Thinking beyond the rush to implementation

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Construction of a new central infrastructure for Faster Payments in the UK is underway and scheduled to allow near real-time consumer payments by the end of 2007. This infrastructure will be operated by Immediate Payments Limited, a joint venture company set up between LINK Interchange Network, which manages the UK ATM network, and VOCA, the company that operates the current BACS scheme for moving different types of payments between corporate entities.

Faster Payments comes at a time when the payments landscape across Europe is being dramatically altered by legislation and self-regulation of the banking industry. In the new Europe, payments is viewed by the regulatory bodies as an area where consumers deserve a better deal – meaning the provision of a free market for financial products allowing the consumer the ability to access financial services from whichever provider they choose, at the lowest cost, across all countries in the Euro zone. Consumers must also be accorded comparable levels of service across all European markets. In addition, the EU is proposing a regulation stipulating that after 2010, payments must be cleared in maximum twenty-four hours.

The UK already lagged behind many of its European counterparts, having one of the longest payment cycles. In the Netherlands, real-time clearing and settlement has been a reality for some time and in many countries the payee's account is credited at the latest on the next business day after payment has been initiated. In the UK, the clearing cycle is currently three working days, with consumers effectively having to initiate payment five days in advance to guarantee the timely arrival of a bill payment, for example. The only way to instigate a fast electronic payment at the moment is through the CHAPS system, which is appropriate for wholesale payments but not cost-effective for low-value, high-volume consumer payments. APACS has been mandated by the Office of Fair Trading to ensure that UK consumers are not disadvantaged. In practice, it will mean that the UK remains in step with the rest of SEPA-compliant Europe, even though it is not part of the Euro zone.

A watershed in the payments industry, this ruling has set off a chain of events that will dramatically alter the payments environment in the UK for consumers and businesses, and may also over time affect the way British companies transact payments within the rest of Europe. In the first instance, companies will have an alternative to BACS for certain types of payment – such as payroll, standing orders and online transactions – that ensures the payment is made in real-time. In the longer term, there is obviously potential for more of the country's wholesale payments traffic to flow through the Faster Payments engine. Today 50 percent of all CHAPS traffic falls below the £10,000 maximum transaction value of the Faster Payments Service and could therefore go this route. Ultimately organisations from outside the UK could be able to link into the country's payments system using a Faster Payments interface. For the first time, Faster Payments will allow large corporations to become part of the payment authorisation process, allowing them to accept or reject, in real-time, payments made to them.

The system will only handle sterling at first, but there is no technical reason why other currencies may not be introduced. Not only will banks have to invest time and resources in upgrading their systems to deal with the new regulations, so will larger corporations and businesses.

Time will tell how far the system is extended and whether CHAPS and BACS ultimately become redundant. For the time being, the UK banks that have to link to the Faster Payments infrastructure have a significant task on their hands.

What and When

Initially, the Faster Payments system will be used for online and telephone payments, as well as standing orders. From November 2007, these types of payment will no longer be cleared and settled through a three-day process, but will be handled in near real-time and finalised within two hours.

Immediate Payments Limited will operate a net settlement system between the member banks, with the Bank of England determining a maximum exposure limit for each of the member banks who connect to the infrastructure, to ensure they can cover their settlement positions. Each member will be responsible for the settlement of all transactions made by their sponsored participants.

There will be three different types of payment – those to be executed immediately; those that are diarised for payment at a future date; and standing orders, which are regular payments to the same recipient. As the maximum payment value for an immediate payment has been set at £10,000, it is likely that low-value CHAPS payments may also be handled through Faster Payments, which may be more cost-effective for amounts less than £10,000, although for now the ceiling amount will prevent the decline of CHAPS altogether.

Implications – Technology Infrastructure

Eleven UK banks account for the majority of the country's consumer payments and act as clearing banks for smaller financial institutions. These eleven banks have committed to connecting to Faster Payments through a direct link. Smaller banks, building societies and even some larger companies can elect to have their own direct connection to the infrastructure, or they can use one of the participating banks to facilitate access on their behalf. A third alternative is to use a third-party service bureau, which will aggregate transactions and operate a switching service to route payment traffic into the Faster Payments network.

Organisations needing to connect to Faster Payments will need to implement their technology solutions quickly, so that they have

time to perform testing during 2007, before the infrastructure goes live. Any solution under consideration will preferably be non-invasive, being able to sit in front of the existing IT architecture and interface to the online systems. This approach will require less effort on the part of technical staff, who are stretched at the best of times, and will be a lower-risk alternative to extensive platform re-engineering.

The eFunds Solution

eFunds Faster Payments Access Node is fully compatible with the central Faster Payments infrastructure and can act as a single point of contact between existing batch processing systems, real-time channels and the Faster Payments hub.

The eFunds Access Node performs all initial validation of the funds movement requests and enhances the message data to ensure that it reaches its Faster Payments destination without being rejected due to lack of Straight Through Processing information.

The investment in compliance will not be cheap for UK banks. As with all compliance issues, the business case is not appealing at first glance – the main reason governments regulate banking is because banks fail to make changes that are too expensive to justify in a world of shrinking margins and increasing competition. However, with the right solutions, compliance situations can be used to create business advantage, if not to drive additional revenues then at least to consolidate operations and improve efficiency.

That's why, over time, the eFunds Faster Payments Access Node can be extended to become the central hub for all the banks' existing systems. Given that it is part of eFunds' complete EFT product set, it can be extended to drive the bank's delivery platforms (ATMs, POS, Internet and so on). As such, it would integrate transactions from multiple internal sources and from external sources, as well as providing a rationalised payments platform capable of handling both retail and corporate payments. For banks wanting to achieve a single enterprise platform for all payments, the Faster Payments Access Node can be developed to route all payment types across all channels.

The Fraud Question

So far, most banks needing to connect to Faster Payments have concentrated on the first step – how to make the physical connection. Up to now, this has been largely a technology and compliance issue, trying to get the systems in place ahead of the deadline. Not many have had the time to stop and fully consider the additional impact that Faster Payments will have on their business, most significantly from a risk and fraud management perspective.

Moving from a three-day payment cycle to near real-time clearing and settlement has implications for those who manage the financial institution's exposure, not just to settlement limits, but also to fraud. In the past, banks have been able to consider more or less at their leisure whether a cheque will take an account into overdraft and should be bounced. Similarly, they have had time to examine Internet-originated transactions to determine whether the cardholder is bogus before agreeing to accept the payment. Existing transactional fraud detection systems are largely geared towards analysing fraud occurrences after the event. The ability to shortly be able to pump large volumes of payments through the banking system and have them finalised within two hours must surely have caught the attention of the criminal fraternity, which is long-accustomed to inventing new scams to defraud banks and their customers as soon as any changes are announced to the way banks handle payments.

At this juncture, it is hard to predict what the impact of Faster Payments might be on fraud levels. However, banks may be well served to consider the possibility that their fraud risk may be increased and to spend some time modelling what the expected impact may be on their own environment. It does not take a genius to work out that you cannot perform the same fraud checks on each transaction in two seconds that you could undertake in seventy-two hours. Criminals may be excited at the speed with which they can now move money between places. How will Faster Payments change the internal requirements for vigilance against money laundering, for example? With the ability to split up large sums of money into a sequence of smaller payments, submit them for immediate payment and reunite them later in a destination account, criminals may find it easier to avoid

detection of suspicious large payments through the clearing system.

On the risk management side, what will be the effect on settlement risk of a large slice of CHAPS transactions flowing through the same system as consumer payments? How will clearing banks, and the smaller banks whose business they handle, share adequate information about funding levels on accounts to verify that funds are available to honour standing orders, which can now be up to £100,000, at the point when they are launched? Another key area of concern is the ability to control the activities of agency banks, so that they do not jeopardise the overall net settlement position allowed by the Bank of England. Now that liquidity is concentrated in a central pool, used by transactions from multiple sources, what new policies and management practices have to be implemented?

Faster Payments does not alter the upfront requirements of Know Your Customer. Identity verification and customer authentication procedures when opening accounts will not change. Similarly, Faster Payments does not increase the likelihood of being able to gain access to other people's accounts. The level of security will be the same. In fact, it may be higher, as more banks opt to introduce multi-factor authentication on online transactions. However, once an account is compromised or an identity stolen, it will be much easier to steal much more before the pattern of fraud is picked up and the card or account is blocked. What new fraud prevention measures need to be put in place to provide a sufficiently rapid response when criminals manage to hijack a customer's identity?

Likewise, with the advent of new payment types such as prepaid cards, which are more difficult to track and also provide a vehicle for frequent top-up, there may be increased vulnerability to money laundering. These new payment types have enormous business benefits for banks seeking to tap into new market segments and extend customer choice, but they also introduce new types of risk that must be dealt with.

Thinking further ahead to a time when Faster Payments could be further integrated into the broader European payments infrastructure, what if it became possible to make real-time consumer-initiated payments across Europe, through the

PEACH system? The sheer volume of traffic could create headaches for those responsible for monitoring and detecting fraud. Giving access to the UK system to users from abroad also presumably makes it more susceptible to attacks from the organised criminal gangs who have already made scams in the cardholder-not-present environment their speciality. Banks who are considering how Faster Payments may provide them with the ability to offer enhanced services to business customers will need to take the fraud element of the equation into consideration.

Customer support

Now that a bank's customer can initiate immediate payments at any time of day or night, they are also going to need to contact its support teams when things go wrong. 24 hours, 7 days a week, 52 weeks a year support is going to be demanded for Faster Payments. This requirement impacts managers operating bank call centres and help desks, who may not yet have realised the full implications for their staffing and facilities. At the moment, most UK banks only have support staff available during the normal office hours of 9am to 5pm. When standing orders start to be initiated between the hours of 2am and 4am under the new system, somebody will need to be on hand to answer queries. Similarly, those staff that handle exceptions and disputes could just as easily be called on the middle of the night, instead of during the working day because customers will want immediate answers within the two-hour finalisation window.

Initial Answers?

Most banks today do not have systems for monitoring transactions for fraud in real-time. Those systems do exist, but they represent another layer of investment that makes the business case even less appealing. One way to tackle the problem will perhaps be to focus more on monitoring for fraud at the level of accounts, rather than transactions.

There are cost-effective ways to improve fraud monitoring at the transactional level. eFunds FraudManager, for example, allows basic inline transaction-based checks to be performed. This tool permits banks to apply predetermined rules to individual accounts or transactions, preventing behaviour on cards or accounts that is likely to

be fraudulent, such as using the same card in two ATMs at adjacent locations within a given timeframe.

There are also ways to gain better overall control of the transactional back-office, making incidences of fraud easier to spot and simplifying fraud analysis. eFunds DataNavigator® provides online, near real-time access to all of the data associated with transactions and consolidates that data in a single repository. The data is easily accessible seconds after the transaction is executed, so that the bank's fraud analysts can have a complete view of all activity going through its Faster Payments gateway and actively seek out suspicious patterns of behaviour on accounts.

To address the issue of liquidity management, eFunds is able to provide the capability through the Faster Payments Access Node to keep running totals of transactions from various sources, which the bank's risk management team can view through an online interface. Consequently, the exposure to agency bank activity can be continuously monitored. Each bank needs to be able to keep tabs on the settlement positions of its agencies in order for the overall system to be stable.

eFunds also has the ability to help with the provision of round-the-clock help desk and customer service support. As one of the leading providers of outsourced services in the financial services sector, eFunds has considerable expertise in back-office processes that support card management and electronic payments. For example, inbound customer queries can be routed to one of the company's contact centres for immediate resolution. Similarly, eFunds could provide transaction analysis and monitoring services using the back-office data collected in DataNavigator and staff who are available 24 hours a day. These staff could also handle exception and disputed transactions, through secure remote access to the bank's systems, or assist customers with the set-up of standing orders on their account.

Summary

Faster Payments is probably the most disruptive change to UK banking for many years. The deadlines involved require banks to make decisions about strategy and implementation

in a short timeframe. As they work through the business and technical requirements, many questions will be raised, demonstrating that this is far more than a technology upgrade and has ramifications for several areas of the bank's operations and corporate governance. As with all compliance projects, it will involve cost that the banks would preferably not have incurred, yet there are opportunities for the Faster Payments infrastructure to be used positively to create an efficient and timely system of retail and wholesale payments in the UK, as part of the changes necessary to remain competitive in the European banking market after SEPA.

The danger with compliance projects is always that banks may rush to complete the necessary technical changes without thinking strategically about how this investment can be used to the positive. Or, at the very least, to consider the potential negative impacts which also have to be strategically avoided.

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As Director of International Marketing at eFunds International, Karen Williams leads the team responsible for managing a series of high value integrated marketing campaigns, which create extensive market opportunities for eFunds across the whole of the International division.

Combining this role with Director of Global Outsourcing Solutions, one of Karen's major successes was the launch of eFunds Global Outsourcing Solutions business in the UK in 2001. Karen was responsible for managing relationships with clients using the company's offshore outsourcing services. Her role included overseeing UK sales, marketing, implementation and ongoing customer development.

Karen joined eFunds in early 1998, after working in marketing communications for another major US corporation. Before this, Karen also worked as an independent PR consultant.

About eFunds

eFunds Financial Services Solutions is a subsidiary of eFunds Corporation (NYSE: EFD). With more than 30 years of payment processing and information intelligence expertise, eFunds delivers flexible, innovative solutions to the world's leading businesses. Leveraging mission-critical business insight, eFunds enables financial services companies, retailers and government organisations to grow their businesses while reducing transaction and infrastructure costs, detecting potential fraud and building long-term customer value. eFunds' flexible delivery model means solutions can be run in-house, outsourced or anything in between, helping customers balance the need for control with operational efficiency and low cost of ownership. From the point of account opening to the settlement of every transaction – debit, credit, or prepaid – eFunds helps businesses win more of the right customers, serve them more efficiently and keep them. Additional information is available at www.eFunds.com.



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