



# Wire Transfer System Debate

*Research into the pros and cons of two technical formats suggests a bridge to the future*

*George F. Thomas*

Businesses and banks agree on the need for a better wire transfer system, yet there is some debate over technical standards. While the European Union is driving a format that will become the cornerstone of SEPA, the Clearing House Payments Company has developed a format that is faster and cheaper to implement in the U.S.

In 2006, the Federal Reserve Banks and the Clearing House Payments Company conducted research that concluded that the U.S. dollar wire transfer systems—Fedwire and CHIPS—need to be enhanced to be viable options for the migration of some business-to-business checks to wire transfer payments. The research clearly stated that the limited unstructured remittance information fields that exist today make it impossible for a company to automate the receipt of a wire transfer payment. Furthermore, if a company is receiving payments from a thousand trading partners, the remittance information may come in a thousand different ways.

There is little debate among the banks or the payments system operators that the systems require upgrades to increase payments automation. They also agree that the systems need enhancements to carry structured remittance information to enable automated reconciliation and posting to accounts receivable systems.

## **The debate: Which technical format to use?**

The banking industry is wrestling with which technical format to use, the XML-based ISO 20022 or the streamlined X.12 820 known as the STP 820, developed by the Clearing House Payments Company. At a 30,000-foot level, the ISO 20022, which is making its introduction as a potential global standard, would seem like the logical winner. That is until you evaluate and understand that there is no business case for the U.S. to move to this standard in the next 10 years. The ISO format is driven by European Union regulation and will be the cornerstone of the Single European Payments Area (SEPA) for cross-border low-value bulk payments (ACH) within Europe. All banks that want to participate in a pan-European environment need to comply, including U.S. banks that have a global presence. The ISO 20022 has not as yet been implemented, though it should be in place by 2010.

## **The business-to-business payments opportunity**

Research conducted by the Federal Reserve in 2001 found that more than four billion check payments were written for transactions between businesses or between businesses and governments. A similar study will be conducted this year, with similar results anticipated. Compare that to the cross-border opportunity that exists with the major U.S. trading partners—less than 85 million commercial payments in total, according to a 2006 International Payments Research Study, conducted for the Clearing House Payments Company by Global Concepts.

This suggests that banks have an opportunity to help business customers automate wire transfer payments. True straight-through-processing—the seamless flow of information from a company's accounts payable system to its trading partner's accounts receivable systems—can be increased by the use of the wires by business customers and provide a value-added service that will generate additional revenue for banks.

## **ISO 20022: Benefits**

The ISO 20022 format could be the global, cross-border standard that will permit the seamless transmission of payment instructions, first within Europe, then between the U.S. and Europe, and finally worldwide. Questions remain about return on the investment of time and resources compared to the global opportunity.

## **ISO 20022: Barriers**

The Federal Reserve has estimated that it would take six to seven years to redesign Fedwire for the ISO 20022. If the banking industry waits to upgrade the wire transfer systems for business-to-business payments until the ISO 20022 is ready for the U.S., it would lose the opportunity to capture any of the four billion business-to-business payments that exist domestically. Most of the payments that would have migrated naturally to the wire transfer system will have moved to the ACH. The ACH already has more automation and the ability to carry structured remittance information.

Other major barriers are:

- Cost to the banking industry to implement for the payments system operators and the financial institutions
- Cost of maintaining current systems until broad adoption is possible, estimated to be 20 years in the U.S., according to a 2006 Celent B2B study
- No return on investment for payment system operators or financial institutions that are not global players
- Unproven standard in payments systems
- Cost and time for businesses of all sizes to implement in their enterprise resource planning (ERP) or accounting systems
- Cost and time for cash management and accounting software providers to implement the complex standard into their accounting packages
- Cost to develop remittance delivery capability using the new standard for business customers by financial institutions

## **STP 820: Benefits**

The wire transfer systems can implement this simplified 820 standard in a much shorter time frame than the ISO 20022. The CHIPS system is already structured to carry remittance information, and this data can be conveyed internationally using the SWIFT MT 103 Remit format. Fedwire would have to be enhanced to carry additional remittance information. While this is not a trivial task, it can be accomplished in a couple of years, versus the time that would be required to develop and test an entirely new system.

The benefits of using STP 820 standard rather than developing a new standard or trying to use the ISO 20022 standard are significant:

- Speed to market—large corporations are able to process the STP 820 into their ERP packages without any upgrades or changes.
- Cash management software vendors are already implementing the STP 820 for their ACH cash management offerings, adding it for wire transfers that, according to several of them, will not be extremely complicated. This will enable the small and mid-size business market as well.



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- Banks already have EDI delivery platforms that can be used to deliver the STP 820 to their business customers today. Though there is cost initially to bridge this internally at financial institutions, in the long term this will streamline infrastructure and maintenance costs.
- This is the first step to streamlining front-end applications for business customers. One interface should enable a company to send a wire or ACH payment with the same type of remittance information to their trading partners, regardless of the settlement needs—real-time or next-day.
- Based on a 2004 payments study conducted by AFP, most corporations do not have XML in their five-year plan for payments.

## STP 820: Barriers

The primary barrier to the STP 820 is that it is purely a U.S. standard. Global banks would prefer to upgrade wire transfer systems only once. Since they must implement the ISO 20022 for Europe, they would prefer to implement the standard in the U.S. as well. Nevertheless, the standard should not be driven by a few large global banks for their own benefit. The impact to all U.S. financial institutions, network providers and companies should be considered. It is interesting to note that the European real-time, high-value systems (Target II and Euro I) have no plans at this time to implement the ISO 20022, and it is being implemented for the bulk transfer low-value payments systems only because it is mandated as part of SEPA.

## Waiting for the future

The business community is looking for electronic payments solutions now, not 10 or more years from now. If the banking industry takes the right steps, it should be able to implement structured remittance information using the STP 820 in two years. Banks that want to wait for a global standard to be implemented would be doing a disservice to their customers. I would suggest that their real goal is to do nothing under the guise of wanting the long-term strategic solution. The ISO 20022 may be the global standard for the future, but that does not mean we should sit around and wait for all the payments systems worldwide to adopt it. We can

make progress today and take steps to bridge for the future environment.

## Bridge to the future

A way to accommodate the U.S. domestic and the international needs is to use mapping, a technique used between the U.S. large-value systems and the international marketplace for almost 20 years. CHIPS and Fedwire each have their own formats but are field-for-field compatible, both in number of fields and field size with the SWIFT MT103 format. This field-for-field compatibility provides for transparent mapping among the systems.

A compromise solution would be to ensure that the STP 820 and the ISO 20022 are field-for-field compatible, so they can be mapped to each other seamlessly. Mapping is a much-lower-cost alternative than implementing completely new payment systems for over 15,000 financial institutions and millions of business customers. A conversion to an ISO 20022 format would never be a big bang implementation, and mapping would still have to be implemented for those that are not on the same implementation schedule.

Another option, the SWIFT MT103 and CHIPS payment instructions can carry 9,000 characters of remittance information today, with three options: ANSI X12, UN/EDIFACT and user-defined. A new designation could be added to include the XML ISO 20022. XML messages are known to be character-intensive and use three to ten times more characters than other computerized formats; however, this would allow the ISO standard to be used for global payments. The XML-based information would limit the number of invoices to be included to approximately a dozen.

## Critical infrastructure

Banks have demonstrated over the years that they will act only when forced. A prime example is the neglect of the wire transfer process, which remains almost entirely manual. The banking industry needs to move expeditiously to enhance this critical payment infrastructure for the benefit of its customers and the industry. The ultimate question is whether the banking industry has the vision and leadership to do so or whether it will debate the topic until the opportunity passes by. The corporate community is waiting for an answer.