RISK EVALUATION IN ELECTRONIC FUNDS TRANSFER

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Abstract

The paper examined the numerous frauds that banks have sustained over the years in offering funds transfer services. In many instances, banks have not just suffered financial losses but have also faced tremendous amounts of negative publicity. The study showed that most of the losses are due to poor internal accounting and administrative controls. Banks should identify components involved in providing an ideal, risk-free funds transfer and consequently ascertain deviations from the ideal and then evaluate the acceptability of assuming increased risks. The study outlined fifteen steps to such an ideal funds transfers. Guidelines for transfer system processing and incoming credit transactions have also been suggested. Management must decide either to tighten controls over funds transfer to an acceptable level of risk or accept the potential exposure to fraud and avoidable errors.

Introduction

Banks have sustained numerous frauds in offering funds transfer services. In almost every case, thieves have found a weak link in the transfer process without having to penetrate the bank’s high technology areas. Take, for example, the unauthorized bank employee who was given physical access to the wire room and discovered the password of the day despite a bank policy to the contrary, or the bank employee who failed to verify an incoming telex that was later found to be fraudulent. And take the bank that did not have a control procedure to prevent the account officers from initiating fraudulent customer transfers, or the bank phone operator who told a customer that the accounts he tried to debit for the transfer were nonexistent until the customer finally guessed an authorized account. In each of these cases, the banks suffered both financial loss and tremendous amounts of negative publicity.

To evaluate the extent of internal as well as external fraud risks your bank is assuming, it is necessary to identify the components involved in providing the ideal, risk-free funds transfer. From that basis, you can pinpoint any deviations from the ideal and evaluate the acceptability of assuming increased risk.

This paper outlines 15 steps to an ideal funds transfer. It should be understood that these steps become blurred in many banks. However, the distinctive controls still need to be in effect to make sure that overall integrity is maintained.

Guidelines for Outgoing Transactions

1. Make sure that an outgoing instruction is accurately recorded and that the original instruction is protected from loss or alteration. To initiate the funds transfer process, a request can come from a variety of sources.

   The operator should not coach the sender through the information to be taken. The bank must establish a policy on error resolution so that the operator knows what information should not be discussed with the customer. Unless there are compensating controls, some banks only accept standing orders over the phone because of the risks involved.

2. Authenticate the identity and authority of the sender and make sure the outgoing instruction is accurate and complete. Once the information has been captured, the transaction must be reviewed to guarantee that the data are complete, that the sender had the proper authority to initiate the transfer and that all of the information received conforms to the standards established by the bank for fund transfers.

   The bank must ensure absolute identification of the customer before any action is taken. Simply recognizing a voice is not enough. Additional controls such as call-back must be initiated.

3. Make sure collected balances are available and held for the outgoing instruction. Any deviations must be considered a credit decision. At this point the information on the transaction has been validated.
but the amount of the transfer still has to be compared with the customer’s “collected” balance before the transaction can be released. A risk-free transfer would involve collecting funds in amount at the time of the transfer. After it has been verified that the customer has collected funds, a hold must be placed on those funds so that they are reserved for this transfer. Any transfer approved where there are not collected funds are considered credit extensions.

4. Make sure the original, unaltered, outgoing instruction is entered into the internal accounting system and into the appropriate transfer system. The original outgoing instruction received from the customer must be converted into an acceptable format recognizable by the bank’s internal accounting system. It is important that the original outgoing instruction not be altered and that any problems or questions be resolved promptly.

In addition to the internal accounting system, the outgoing instruction must be converted into the form acceptable to the transfer system. In practice, additional information is entered and the outgoing instruction is automatically routed to the designated transfer system.

5. Verify that the original, outgoing instruction has been accurately processed through the internal system and the transaction has been released to the designated transfer system. Verify that it has not been altered and that it is being released to the correct transfer system. May times the special instructions on the transaction may specify the requested means of transmission.

6. Make sure that, once the transaction has been released, the transfer system acknowledges the receipt of the outgoing instruction. It is important that the sequence number be recorded to guarantee that messages have not been missed or duplicated and that fraudulent messages have not been introduced by another party posing as your bank.

7. Make sure all original, outgoing instructions and processing steps are documented adequately and maintained for the required time. There are several additional controls that need to be verified in the funds transfer process. Fully documenting each transaction helps guarantee that each transaction can be traced through the system. Knowing where transactions are at any point in time (throughput control) ensures that all transactions are processed in a timely manner. In addition, statutory laws require retention of the documentation for a specified period of time.

8. Make sure final, daily balances and the subsequent end of day processing meet the following objectives: internal system are in balance with the transfer system, all transactions are booked accurately into the internal accounting system, timely advice is provided to the customer and original, outgoing instructions are accurately accounted for.

At the end of each day, certain procedures must be performed. They include checking that the customer’s account reflects the transaction, advising the customer that the transaction was sent, and verifying that the internal accounting system is in balance with each of the funds transfer systems used and that all the documentation for the funds transfer request is accounted for accurately.

Guidelines for Transfer System Processing

For each transfer system utilized a detailed definition of the mechanics of the processing and the settlement procedures must be documented. For each transfer system utilized, every transaction released must be accounted for, and the total bank’s position must be known at all times. Once a bank has received and processed outgoing instructions, it is necessary to forward payment to the beneficiary’s account. There are many different transfer systems available to accomplish a transfer. The simplest is through an internal bank accounting transfer between two customers at the bank, two respondents of the bank or the bank and one of its respondents. These transfers should not be taken lightly because there may be an associated legal liability, unknown to the bank, that they may result from the untimely transfer of funds.

External transfer of funds can either be facilitated through a transmission facility with settlement or without. Many message switching systems such as Telex and the Society for Worldwide Interbank Financial Telecommunications (S.W.I.F.T.), are not settlement systems for funds transfer transactions.
Federal Reserve Communications (Fedwire), Clearing House Interbank Payments System (CHIPS) and Cash Wire are the external transfer systems with settlement facilities. The key points each bank should be cognizant for are:

- Know your own net settlement position.
- Be cognizant of the processing hours maintained by the transfer system to avoid potential problems that can occur if an outgoing instruction is not executed.

Guidelines for Incoming Credit Transactions

9. Verify transfer system identity and make sure that the incoming credit received is accurately recorded and protected from loss or alteration. The reciprocal process of the outgoing transaction is established for an incoming credit transaction. However, before capturing the incoming credit, a procedure should be in place to establish the identity of the transfer system to prevent the receipt of fictitious transfer. Once identity is established, the transfer must be captured from the transfer system. The bank must be aware of its responsibility for missed or garbled transfers and that controls are established to prevent this from occurring.

10. Make sure incoming credit is accurate and complete. After the transfer is received, it must be verified to guarantee that the information was not garbled or incomplete. Any indication of missing or incomplete transactions should automatically require the bank to request a retransmission. If the problem recurs, the transaction should not be accepted.

11. Make sure that the incoming credit transaction represents funds that are collected before processing further. The ideal transfer should only be complete after collected funds are received. If the transfer comes from FedWire, it does represent collected funds. However, the bank should be able to distinguish between the different types of transfer and their associated collectability.

12. Check to see that the incoming credit is credited to the correct account for the right amount. The credit must be entered into the internal accounting system. It should be re-emphasized that the incoming credit should be reviewed for altered or lost information and that the current account is credited for the right amount. Too many times funds leave the bank due to an error on the transfer resulting in an incorrect customer account being credited. Recovery from this type of error may be impossible, and a loss is usually suffered.

13. Verify that the incoming credit has been processed through the internal system accurately and notify the account holder as instructed. All incoming credits must be processed through the funds transfer system in accordance with established internal bank procedure. Key information including account numbers/names, naira amounts and special instructions must not be altered without appropriate documentation. If the transaction is verified, it should be released to the accounting system and the customer should be notified in accordance with special instructions on the credit transaction or standing orders. If neither is present, bank procedures should be relied upon to dictate the mechanism by which the customer is to be notified.

14. Check to see that all incoming credits and processing steps are adequately documented and maintained for the required time frame.

15. Make sure the final daily balances and the subsequent end-of-day processing meet the following objectives: Internal systems are in balance with the transfer systems, all transactions are booked accurately to the internal accounting system, timely advice is provided to the customer and incoming credits are accounted for accurately.

At the end of the working day, there should be controls established so that the internal accounting system is in balance with each transfer system utilized, that all incoming credits are properly recorded in the accounting system, that the customer has been notified of the credit to their account and that all documentation has been properly retained.
Environmental Controls

There are two other areas that have an impact on the quality of the EFT environment. Those areas include controls over specific items that affect the individual transfer transactions and, those specific items that should already be controlled within the banking environment.

Areas directly affecting funds transfer requests within the funds transfer area include establishing controls over training funds transfer personnel, utilizing encryption, authentication and communications protocol and maintaining a physical secure environment.

Areas outside funds transfer that should already be controlled include standard over software development of funds transfer systems as well as hardware acquisition, personnel hiring and dismissal policies, organizational reporting controls, the establishment of operational review of computer related activities (e.g., data security), internal audit and maintaining compliance with regulatory reporting and review procedures.

Evaluation of Risk

To evaluate the level of risk you are assuming in your wholesale funds transfer system, you should identify how your bank is performing each of the 15 processing steps outlined in this article. If you are not performing one or more of the processing steps, you have found a potential pitfall in your system.

For each processing step you are performing, determine what criteria you are using to perform that processing step. For example, if you are evaluating processing step three and find that a transfer can be released where the account does not yet have collected funds, you should evaluate the process the transaction goes through. Is the wire room required to call the account officer for approval? If so, how many calls are initiated each day? What criteria does the account officer use to approve the transfer?

This evaluation process, initiated by an appropriate level of bank management, will uncover many procedures performed simply to maintain operational efficiency at the cost of increased bank exposure. It is bank management's responsibility to evaluate the risk and to determine if it is willing to accept that level of risk.

Summary

With each transfer that a bank either initiates or accepts, many distinct variations from the ideal transfer occur throughout the funds transfer process. Without properly evaluating the risks and/or the costs of accepting that additional burden, the bank may be positioning itself in a potentially unprotected manager. Whether you have an IBM-PC available for 10 transfers a day or are facilitating the online transfer of your corporate customers, you must properly evaluate the true risk you are assuming. Once this is done, an appropriate level of bank management must decide either to tighten controls over funds transfer to an acceptable level of risk or accept the potential exposure to fraud or unintentional errors.

Works Cited


