CROSS-BORDER PAYMENTS: SUCCESS FACTORS AND CHALLENGES

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Moving into implementation phase – From analysis to action

The G20 roadmap for cross-border payments encompasses a variety of actions through 19 building blocks to enhance cross-border payments. The FSB presented the progress during the first year of the roadmap implementation in a recently published progress report[1].

This report positively assesses that most of the milestones set for 2021 have been successfully completed or are close to finalization. The level of achievements so far lays a good foundation to progress on the forthcoming goals. While 2021 focused on taking stocks and analysing the issues at stake, we are now moving into the more concrete implementation phase.

This move will more than ever require extensive engagement with all relevant private and public sector stakeholders. An appropriate engagement and governance for the practical implementation of building blocks will considerably increase the potential that these have in redesigning the international payment landscape. This is the case for those building block focusing on ambitious solutions such as directly linking payment systems across borders (BB13), but also for compliance matters and a more efficient and effective implementability of AML/CFT (BB5).

BB13 is seen as a promising means in improving overall cross-border payments and there are several existing initiatives exploring this field. That's where also model Nexus comes in - an ambitious project aiming to investigate the overall feasibility of connecting the real-time payment systems across the globe. The Nexus ongoing proof of concept is experimenting with connectivity of TARGET Instant Payment Settlement (TIPS, the Eurosystem pan-European service that settles payments in central bank money around the clock in real time) with similar systems under jurisdiction of the Malaysian Central Bank and Monetary Authority of Singapore. With regard to enhancing current payment system arrangements, it should be mentioned also that the ECB and the Sveriges Riksbank in collaboration with the Banca d'Italia are working on how TIPS can support efficient payment transactions across different currencies.

All these projects (if) once operational have the potential to be transformative and deliver meaningful economic progress around the globe enabling cross-border payments becoming cheaper, faster, more transparent, and more widely accessible.

But one cannot remind often enough that the efficiency and effectiveness of the implementation of AML/CFT rules needs to be further improved. We noted that even within the euro area, "cross-border" (say between France and Germany) instant payments have a significantly higher rejection rate than "domestic" (e.g. within France) because of AML/CFT false-positives. The Commission is taking up this issue in the EU context, and also Nexus has identified this as an issue for BB13 at a global scale. But the issue is not only relevant for instant payments, but for any cross-border payments.

Embracing transformation in new cross-border environment will impact the way banks, both large and small, conduct their payments business in the cross-border space today. Furthermore, it will affect many different systems within payment service providers' infrastructure with complex changes to data, processing and applications. The scale of change required will be extensive. Therefore, banks and payment infrastructures in general should start considering what these changes to cross-border payments might mean for their own technical and operational processes. This will require preparing concrete migration plans by considering internal systems' readiness to support the move to this new environment. Moreover, all relevant players will need to start also considering budget and investments to implement these changes. While the overall effort and investment is undeniable, they are expected to be outweighed by the global benefits they would incur.

Both the public and private sector need to start preparing for these much needed, and transformative changes. Their implementation will take time but the highly recommended FSB report on quantitative targets[2] has set a clear expectation to guide our work namely to reach the targets at end 2027 (except for the remittance cost target). Regardless of whether all targets will be reached precisely on time, this FSB report is important and unprecedented as it forced us to think through what we want to achieve, what we can likely achieve, by when, and how we can measure it.

End of 2027 is an ambitious timeline for achieving all the targets but with all relevant public and private players' commitments and firm actions I stay confident that we will deliver. We at the ECB stay committed to the work and will do our part.

[1] G20 Roadmap for Enhancing Cross-Border Payments – First consolidated progress report: https://www.fsb.org/wp-content/uploads/P131021-1.pdf

[2] Target published in the report Targets for Addressing the Four Challenges of Cross-Border Payments: https://www.fsb.org/wp-content/uploads/P131021-2.pdf

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Improving cross-border payments: there's light at the end of the tunnel

Although slowed by the COVID-19 pandemic, globalisation is a continuing trend. With increasing cross-border trade, cross-border payments need to follow suit in order to continue to ensure economic efficiency. At present, cross-border payments generally remain slower and more costly than domestic transactions, which is why they have drawn the attention of the G20. This international body is currently working on a "Roadmap for enhancing cross-border payments". With regard to regulation, the European Union has taken significant steps towards a fully harmonised landscape. After the introduction of the single currency laid the groundwork, further regulatory initiatives like SEPA and PSD2 built on this foundation to create an innovative and open payments market in the EU, including beyond the countries of the euro area.

On a global scale, regulatory harmonisation is currently lacking, especially in the fields of know-your-customer (KYC) and anti-money-laundering (AML) measures. This leads to high compliance costs and longer transaction times. Furthermore, the variety of prevailing standards makes it more difficult to automate payment processes across borders. This is why the harmonisation of KYC and AML standards plays an important role in the G20 roadmap, which envisions globally harmonised standards enabling straight-through processing of cross-border payments, thus making these transactions faster, cheaper and more transparent.

However, it must also be ensured that the technical back-end infrastructures are able to communicate with one another. In the Eurosystem, TARGET2 and TIPS form the basis of an interoperable back-end infrastructure, which is the main prerequisite for frictionless payments. By allowing other instant payment clearing houses to hold accounts on the platform, TIPS has positioned itself as a pan-European hub for interoperability. With the completion of the final wave of migration this February, full interoperability of SCTInst payments will be achieved within the Eurosystem.

Its design as a multi-currency platform also enables TIPS to cater to the needs of non-euro countries. With the RIX-INST service, it will be possible to settle transactions in Swedish krona via TIPS starting from May 2022. It is expected that the Danish krone will follow by November 2025. While cross-currency transactions are not possible at the moment, the Eurosystem and Sveriges Riksbank are in the process of evaluating whether to enable these kind of payments, with Danmarks Nationalbank also expressing interest in this functionality. Nevertheless, the inclusion of other currencies in TIPS is an important step for European integration.

To improve cross-border payments, adjustments to regulation and infrastructures are key.

In order to further extend the reach of TIPS, additional links to payment infrastructures outside of Europe could be envisioned in the future. One possibility may be to link up with a global hub that connects faster payment infrastructures. With its Nexus project, the BIS Innovation Hub in Singapore has presented a promising concept for the interconnection of faster payment systems around the world. While the Nexus Network provides the standards and gateways, the platform would rely on banks to provide liquidity in the connected jurisdictions. This could further strengthen the role of banks in cross-border payments, as they would continue to be an essential part of the global payments chain. The efforts to harmonise the exchange of payments data globally could further help to make cross-border payments more efficient.

While TIPS already operates on the ISO 20022 standard, TARGET2 is currently in the process of converting to the new standard as part of its consolidation project. The new messaging standard will enable banks to send and receive more information in a structured form, facilitating straight-through processing and the automation of payments. This may prove helpful for cross-border payments as well. Harmonised ISO 20022 messages may be able to transmit harmonised KYC information across borders, thus enabling automated checks to prevent money laundering and the financing of illicit activities for cross-border payments. Considering the fact that SWIFT is aiming for global migration to ISO 20022 by 2025 at the latest, this will allow TARGET2 to be interoperable with other real-time gross settlement systems around the world and will be another step towards global harmonisation.

Banks are expected to play an important role in cross-border payments as well. However, they may have to keep evolving in order to stay ahead of the competition. Most importantly, they need to play an active role – both in the development and implementation of the G20 roadmap – and must be active participants in the payment infrastructures of the Eurosystem. This way, adjustments to both infrastructures and regulation will benefit from the valuable input from experienced market players.

MARC
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Stemming the settlement risk tide: widening access to PvP in the FX market

The FX market widely recognizes that payment-versus-payment (PvP) is the most effective way to eliminate FX settlement risk in cross-border payments. Despite this, the proportion of FX trades not settled on a PvP basis has increased in recent years, leaving market participants more exposed to settlement risk.

This rise in settlement risk is predominantly driven by an increase in turnover of trades involving currencies not settled through PvP services. Analysis conducted with settlement members by CLS – which operates CLSSettlement, the world's largest multicurrency FX settlement service – supports this assertion. The findings demonstrate that the majority of addressable settlement risk lies with currencies that are ineligible for CLSSettlement. Results of the Bank for International Settlements 2019 Triennial Survey show that trades involving a non-CLSSettlement-eligible currency amount to circa USD1.25 trillion. This is an increase from approximately USD930 billion (or 35%) since the 2016 Survey. The US dollar (USD) and euro are on one side of the vast majority of these trades, but without PvP settlement, both sides carry settlement risk for CLS settlement members and other market participants.

While clearly safeguarding the ecosystem, the current regulatory regimes applied to financial market infrastructures (FMIs) like CLS place significant barriers to entry for adding new currencies into CLSSettlement. The solution may lie in developing an alternative PvP mechanism for a specific set of currencies that offers similar benefits to CLSSettlement, including capital and liquidity efficiencies, and is tailored to market needs. PvP services, like CLSSettlement, significantly reduce the funding requirements to settle FX transactions compared to gross settlement or less standardized bilateral netting arrangements.

Other benefits of adopting PvP settlement would include maximizing the advantages of straight-through processing to deliver operational efficiencies and minimizing associated costs. In addition, a PVP settlement mechanism would enhance market participants' ability to reach a broader network of trading counterparties and use their existing credit capacity more efficiently, leading to potential business growth opportunities.

A public-private approach is the optimal model for an alternative PvP solution.

Wider PvP adoption would also support policy recommendations to mitigate settlement risk, as outlined in the Financial Stability Board's Roadmap to enhance cross-border payments and the FX Global Code. CLS has been exploring the opportunity to develop an alternative PvP mechanism,[1] and has established a working group of 12 banks with global operations to evaluate market demand and explore approaches. As part of this initiative, an industry pilot is underway to evaluate the impact on liquidity and settlement risk of potential models.

The PvP model under consideration would complement CLSSettlement by enabling asset managers, corporates and third parties to participate directly. Possible features may include settlement windows aligned to periods of peak liquidity, an adjustable model for jurisdiction-specific dynamics, support for same-day funding of trades, settlement sessions for each target currency (versus USD and/or euro) and funding based on multilateral netting.

The initiative has considerable industry support and momentum. However, any new market infrastructure solution must prioritize safety, stability and scalability. For such a solution to succeed, factors such as account structure, legal framework and local market practices and regulations must be considered, and sufficient time allowed for appropriate implementation. Central bank support and engagement is also required to ensure that any solution aligns with each central bank's domestic and international priorities for the currencies under consideration.

To optimally address public policy and industry challenges, e.g., by expanding access to settlement risk mitigation, an FMI must invest heavily in its products, risk management and controls and respective underlying technology on an ongoing basis. CLS has the highest operational standards and has invested heavily in its resilience, cybersecurity and three lines of defense. It also successfully completed a significant phase of a multi-year technology investment program that includes upgrading CLSSettlement hardware and data centers as well as migrating the service to a state-of-the-art technology platform, which will enable CLS to adapt its PvP solutions more easily to the needs of the FX market.

Developing an alternative PvP mechanism for the FX industry is crucial for mitigating rising settlement risk. To ensure that CLS's alternative PvP solution receives the requisite industry investment and support for success, CLS is collaborating with both the public and private sectors. This public-private approach enabled CLSSettlement's success at scale since its launch 20 years ago, and thus proves an optimal model for developing the alternative PvP mechanism.

1. Subject to all necessary approvals.

MASSIMILIANO ALVISINI

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Cross-border payments: building a relationship of trust with our customers

For more than 170 years now, millions of customers across the world choose Western Union because they know they can trust us to send their Money Transfers quickly – often in real time – and safely across the world. We have earned their trust through our focus in covering their needs and our investment in our leading, cross-border, cross-currency omni-channel platform. More than that: we are proud of our role in global financial inclusion and working for migrant communities. We believe that our strong social character and purpose does set us apart in the industry.

Trust then lies at the heart of our relationship with our customers, but at the same time it poses unique demands, especially when we operate a global network that reaches almost every part of the world, in more than 200 countries and territories, and dealing in more than 130 currencies. In this vast network, moving money means complying with dozens of regulatory regimes, laws and regulations. Importantly, when moving money, we must ensure that we always know our customers, know our agents, and that every single cent is not the result of fraud or money-laundering - with close to zero margin of error.

As a company, we have always been at the forefront of technological and social changes. To continue building and expanding this relationship of trust with our customers, and ensure safe Money Transfers, we then constantly invest in technology, including in Artificial Intelligence and predictive analytics, that can assist in implementing responsive controls while also improving customer experience. The use of AI and Machine-Learning to combat ML and TF does improve effectiveness and efficiency dramatically.

Trust, especially with the emergence of new technologies and new players in the industry, is a priority for our sector as a whole, and for policy makers globally, as the safe and seamless flow of cross border payments is truly vital, especially as the world looks to build back better post-pandemic. Against this backdrop, Western Union welcomes the G20 Roadmap from October 2020 for enhancing cross-border payments. That said, we believe that the implementation of the respective building blocks of the Roadmap will need to reflect the unique nature of the various payment providers and business models. There cannot be a 'one size fits all approach' or the reliance on just one standard.

Western Union welcomes the G20 Roadmap from October 2020 for enhancing cross-border payments.

Western Union welcomes in particular the following measures of the Roadmap:

- We believe it is essential that, in the interest of a level playing field, non-bank payment providers have access to intra-bank payment systems, clearing and settlement infrastructure. Within the EU context this means acknowledging that the non-bank payment sector delivers settlement finality under the meaning of the Settlement Finality Directive.
- We support a harmonised anti-money laundering framework within the EU. AML is one of our largest cost when doing business. Despite our sophisticated AML risk mitigation techniques, we are often confronted with decisions by banks to de-risk from the remittance sector. It is essential that non-bank payment providers have access to bank accounts to conduct their business and access correspondent banking arrangements.
- In this context we also strongly support the use and interoperability of cross-border digital e-KYC and e-KYCC solutions. The EU rules need to incentivise us to continue to invest in the most sophisticated AML and fraud prevention solutions available.
- Similarly, data privacy rules should not be in conflict with AML compliance. We would ideally like to see more international consensus on defining the appropriate access to personal or non-personal data subject to the correct safeguards and consent. This will be critical for the development and application of future-orientated technology solutions, such as AI, DLT or data analytics.

Customers will use different means of payment for different purposes. New technologies and market entrants always challenge existing players by reducing costs, moving to faster payments. We believe that a collaborative approach between consumers, the users and providers of payments infrastructures and policy makers can optimise innovation in payments and ensure greater transaction safety. Consumer protection and transparency should always be key in defining regulations. However, such requirements should encourage innovation which will allow the industry to provide for the payments solutions consumers are looking for.

BRETT LOPER
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In pursuit of the next generation of EU payment rules

Over the past decade Europe has emerged as a global pioneer and a standard-setter in payments, driven in large part by the introduction of the second Payment Services Directive (PSD2), considered by many as one of the most groundbreaking pieces of legislation in decades, not least in its requirement to allow banks and other financial players broad access to customer data. This element alone has doubtless boosted significant innovation in the payments sector, and we are only starting to recognize the initial impacts. Even greater transformational changes are certain to come.

Nevertheless, here we are once again – slightly older, wiser and ever more experienced with the ecosystem that PSD2 helped to create – looking to review and perhaps update the rules that were deemed so revolutionary only a few years ago. What, then, are the lessons and the warnings from the last round we should take into the next? What are the key ingredients we should keep in mind for the next generation of payment rules as we begin the review of PSD2?

Implementing all of PSD2's worthy objectives – among others, to create a more integrated European payments market, improve competition, make payments safer and of course introduce greater consumer protections – has proven harder to achieve than many would have thought. The birth pains of PSD2 were numerous, but we believe it is incumbent on us try to address at least three recurring themes that could and should be resolved.

First, the difficult rollout of Strong Customer Authentication (SCA) exemplifies the difficulty in designing market-driven processes.

Second, open banking, specifically the complex technical implementation of access to data for new market participants (known in the industry as APIs), has proved difficult to achieve and is in need of regulatory and legislative clarity.

Finally, the topic of surcharging illustrates a general lack of harmonization in the EU's legal framework which causes significant hindrance of competition in the market.

The architects of new rules must learn from the past while promoting regulatory harmonization.

We have learned, that only maximum collaboration and communication between industry participants and policymakers will give us the chance to avoid SCA-like turmoil, where despite multiple warnings from the former, the effects of the rules were largely underestimated by latter. We believe that an outcome-based approach would have served European consumers far better and, not least, would have encouraged more innovation, just as policymakers wanted. In more practical terms, requiring the payments industry to lower fraud rates and – as the industry repeatedly suggested – allowing the different players to achieve this in their own way would have likely been a more efficient and considerably less painful approach than prescribing the rules with which the payment sector would need to comply to reduce fraud levels.

We also realized from the open banking rollout that ambiguity in the rules must be avoided at all costs, in both level 1 and level 2 texts, and that guidance on the rules from the competent authorities needs to be consistent. The innovations and standards (APIs) that enable open banking are the building blocks for open finance, and even an open data ecosystem. However, before Europe truly ventures into the world of open data, clearer rules, and further prescription of which types of data are in or out of scope, would reduce ambiguity and excessive API iterations. More specifically, an API standardization would lead to further developments and innovations in the field and avoid inconsistent customer experiences that differ wildly across products and providers.

Lastly, rules that actually discourage competition due to the lack of harmonization in the EU's legal framework should be reexamined as part of the PSD2 review. This should first and foremost include examining the current differential rules on surcharging. These rules include inconsistencies that diminish competition and cause significant confusion among consumers and merchants alike. Moreover, they force consumers to "pay for paying" and mislead them as to the true price of goods and services. A full ban on surcharging is the only solution to help protect consumer rights and encourage transparency.

In short, the architects of new rules must learn from the past while promoting regulatory harmonization. These guiding principles will elevate the next generation of payment rules, promote cross-border payments and ensure a smoother payment experience within the EU, which in turn would contribute to the successful rollout of cross border EU solutions.

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2022: a pivotal year for payments in Europe and beyond

2022 is set to be a pivotal year for the payments industry. In November, the eurozone's high-value payment systems – T2 and EURO1 – will adopt the ISO 20022 data standard, aligning the roll-out of a common standard for all payments in the bloc. 2022 will also see adoption of ISO 20022 for high-value payments in the UK (CHAPS) and the standard is gaining traction in many other markets, notably the US, where ISO 20022 is already in use for instant payments and will be adopted for high-value payments (CHIPS and Fedwire) in 2023/4.

Recognising that many cross-border payments originate or terminate in domestic systems, in November the payments industry will begin a three-year migration to ISO 20022 for cross-border payments, adding the final puzzle piece to complete the picture of a global common standard end-to-end for international and domestic payments.

A common interoperable standard promises a variety of benefits for end-users of the payment system, such as new and innovative digital payments services for individual citizens; and efficiencies that will benefit global corporations, such as invoice-processing efficiencies and cash-flow improvements. It provides economies of scale for service providers and users, enabling them to deploy common technology across different markets and payment types, driving down cost and increasing automation efficiency. It enables new business opportunities for cross-border, including facilitating direct interconnection of market infrastructures. And the richer transaction data supported by ISO 20022, combined with the assurance that rich data will be propagated end-to-end without truncation, opens up a wealth of opportunities for smarter, data-based payments products.

Indeed, the FSB/CPMI roadmap to enhance cross-border payments, endorsed by the G20 in October 2020, sets out a number of 'building blocks' to address challenges in cross-border payments, and improving interoperability is a common theme. Building block 14 specifically targets harmonisation of ISO 20022 message formats.

And while alignment to a common standard represents a great step, it's not the end of the story. To fully realise the interoperability benefits, implementations need to remain aligned in terms of processing, data, business rules and service levels. Facilitated by SWIFT and the Payments Market Practice Group, public and private sectors have already coalesced around common and interoperable ISO 20022 implementations for high-value, cross-border and instant payments. SWIFT has long championed the cause of interoperability, in 2015 issuing a widely supported Harmonization Charter, which calls on MI operators to align implementations and maintenance processes.

The years ahead are critical and will reinforce the call for collaboration and partnership.

SWIFT continues to provide practical support and facilitation for interoperability initiatives– and we're working to ensure that the financial industry can adopt ISO 20022 as seamlessly as possible. In-flow translation is key to enabling a smooth transition to the rich data standard, while allowing the industry to keep its existing systems running smoothly and enabling financial institutions to adopt the new standard at their own pace through the industry-defined transition phase up to November 2025.

Interoperability and inclusiveness have always been of paramount importance to SWIFT, as ultimately our strategy is to ensure that value in all its forms can move around the world quickly and securely for as many people as possible.

The years ahead are critical and will reinforce the call for collaboration, partnership within and beyond the European landscape.