GLOBAL CROSS-BORDER PAYMENTS

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Shaping the future of cross-border payments

The G20 adopted in October 2020 an ambitious roadmap to address the key challenges faced by cross-border payments.

One of the first actions in 2021 is to set quantitative targets for the roadmap, for costs, speed, transparency and access, across wholesale and retail markets as well as for remittances. Under the aegis of the FSB a high level task force finalised last May a proposal for those targets, submitted for public consultation.[1] The initial proposal is currently being refined based on the replies and will be submitted for endorsement by the G20 leaders at the end of October.

As stressed in a previous Eurofi article[2], these targets are critical: they set the level of our joint public-private ambition and will ensure that the implementation of the roadmap building blocks remains tied to that level of ambition over time and that progress will be monitored against this backdrop. Overall, the current proposal foresees that the actions under the roadmap will, by end-2027, jointly: (i) drive down the global average cost of retail payments[3] to no more than 1%, with no corridors having costs higher than 3% (the target for remittances being the one already affirmed by the UN SDG[4]); (ii) allow, for the large majority (75%) of payments in all segments, funds being available for the recipient within one hour from the time the payment is initiated (and within one business day for the remaining payments); (iii) ensure all service providers provide a minimum list of defined information (including e.g. total transaction costs) to payers and payees; (iv) help to ensure that all financial institutions and all end-users (incl. individuals without bank account) have at least one option to send or receive cross-border payments.

For the other actions under the roadmap, the first year of implementation has been devoted to stocktaking, a necessary step to acquire a deeper and more concrete knowledge of the key challenges at stake in the various areas for improvement, paving the way for the following impactful actions.

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Expectations are particularly high for the most innovative measures, especially the issuance of CBDC (Central Bank Digital Currency), given their potential to shape the future of payments, at both retail and wholesale level.

The report on CBDC for cross-border payments to the G20[5] proposes different models based on the establishment of multiple CBDC (mCBDC) arrangements. This creates clear opportunities for improving cross-border and cross-currency payments while safeguarding the anchoring role of central bank money.

In 2020, the Banque de France launched an experimentation program on wholesale CBDC to explore this potential concretely. Overall, several experiments confirm that mCBDC arrangements would improve cross-border payments by:

- Streamlining procedures which currently involve long intermediation chains, reducing the operational burden, counterparty risks and costs while increasing transparency;
- Improving the remittances processes, using wholesale CBDC to speed up payment to the beneficiaries in commercial bank money. This illustrates well the complementarity between central and commercial bank money and how it would be preserved with CBDC;
- Facilitating interoperability both between CBDC systems, and with conventional systems, even when RTGS are not interoperable.

By the end of this year, the Jura Project launched in cooperation with the Swiss National Bank, the BIS Innovation Hub and a private consortium led by Accenture, will achieve a new step in exploring mCBDC arrangements. With this multi-jurisdictional partnership, payment against payment transactions -digital euros against digital Swiss franc- will be carried out in real conditions.

These benefits would not come at the cost of either fragmentation of financial markets or a risk that central banks lose control over their CBDC. Indeed, in all those experimentations, the Banque de France retained control over the issuance and the circulation of CBDC, while ensuring interoperability with conventional systems at the domestic level. The outcome of these experiments is promising. Central banks may indeed through the issuance of CBDC help improve the future of cross-border payments. Further analysis and experimentation should take place to confirm this perspective.

[1] FSB seeks feedback on its proposal for quantitative targets for enhancing cross-border payments.
[2] Taking the cross-border payments roadmap forward, Eurofi (April 2021).
[3] The retail market segment comprises the following payment categories: business to business, person to business and business to person, person to person payments other than remittances.
[4] Global average cost of sending $200 remittance to be no more than 3% by 2030, with no corridors with costs higher than 5%.
[5] Building Block 19, Central bank digital currencies for cross-border payments.

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Bringing cross-border payments to the next level: towards a global payments area

The payment ecosystem is undergoing fundamental changes, especially in the domestic context, to meet customers' 21st century demands. As a result, many end users are already benefiting from instant, 24/7, contactless and digital payments. However, compared to domestic payments, cross-border payments are often slower, more expensive, less transparent and inaccessible to certain customers.

The ideal cross-border payments solution would address all these four challenges. Several recent proposals promise just that. They often involve radically different technologies and providers from outside the financial sector. However, it is far from certain that they can actually deliver on their promises. In fact, there is no single, one-size-fits-all solution to enhancing cross-border payments, as the challenges affect end users, payment service providers and payment infrastructures in many different ways at different stages in the transaction chain. The problem is complex and multi-dimensional due in large part to these characteristics:

- End users range from large corporates to small enterprises to private individuals with varying technological and socio-economic backgrounds.
- Services are provided by both banks and non-banks. Payment infrastructure providers include payment system operators and messaging service providers.
- Arrangements include correspondent banking, links between domestic systems, multilateral payment platforms and new peer-to-peer models.

Nonetheless, the G20 believes these challenges can be overcome and endorsed a roadmap to enhance cross-border payments at the end of 2020, pushing the issue high up on the political agenda. The roadmap acknowledges that enhancing cross-border payments for all end users requires a comprehensive, cross-sectoral and ambitious approach. The roadmap aims to improve both wholesale and retail payments (including remittances) and contains 19 building blocks that are grouped in five focus areas: (i) public and private sector commitment, (ii) regulatory, supervisory and oversight frameworks, (iii) existing payment infrastructures, (iv) data and market practices, and (v) new developments, such as central bank digital currencies (CBDC) and stablecoins. The Committee on Payments and Market Infrastructures (CPMI) is leading the development of more than half of these building blocks.

Improving cross-border payments requires a shared vision, global cooperation and sustained effort.

Already in the first year of implementation, a number of initial roadmap actions have been completed. These include a joint statement by the Basel Committee on Banking Supervision and the CPMI on the Supervisory Guidance on managing foreign exchange (FX) settlement risk and the Global FX Code, as well as the successful completion of a week-long hackathon by the BIS Innovation Hub and SWIFT, which highlighted the benefits of ISO 20022 and application programming interfaces (APIs) in enhancing cross-border payments.

In July, a stocktake report on CBDC for cross-border payments was published. The report analysed how CBDCs could enhance cross-border payments, and offered practical recommendations on how to do so. Facilitating international payments with CBDCs can be achieved through different degrees of integration and cooperation, ranging from basic compatibility with common standards to the establishment of international payment infrastructures. Later this year the CPMI will publish a report on the application of the Principles for Financial Market Infrastructures to stablecoin arrangements. Other upcoming reports will help advance the planning and potential designs of payment infrastructures (eg multilateral payment platforms, longer and aligned operating hours of, and wider access to, payment systems).

Looking ahead, some roadmap actions can be accomplished quite quickly, others will take several years. The aim is to make progress as fast as feasible and consult stakeholders widely. Improving existing payment infrastructures and aligning regulatory, supervisory and oversight frameworks will also support the more complex, progressive and novel solutions.

It is critical that we maintain the ambition to make real improvements in payments around the globe, while retaining flexibility. A shared vision and a common set of targets will help to hold this complex global programme on course and allow the measurement of its progress. The Financial Stability Board (FSB) is finalising these targets for endorsement by the G20 in October 2021. Irrespective of the final targets, the accomplishments of the first year of implementation have shown that the two most important success factors are, unsurprisingly, close cooperation and strong ambition by both the public and the private sector.

Bringing cross-border payments into the 21st century to support the changes in the way end users transact will require sustained effort over a number of years to come. It is a huge challenge, but if successful, it will result in widespread benefits for citizens across the globe, both directly and by supporting economic growth, international trade and global development.

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Cross-border payments: a strong global approach is key

The ongoing trends of globalisation, digitalisation and migration are leading to rising levels of cross-border trade and services, purchases from merchants across borders and internationally integrated supply chains, resulting in payments that are transmitted across borders. Digitalisation especially has not only boosted a change on the demand side, but also created new instruments on the supply side, such as crypto assets and stablecoins with potential global reach. This not only brings new challenges for incumbent players, but also raises a number of issues concerning, inter alia, the safety and integrity of the payments market as well as financial stability. Compared to domestic payments, cross-border payments have remained relatively slow, costly and opaque. The reasons for this are manifold.

At the infrastructure level, for example, a lack of links between infrastructures creates long transaction chains with multiple players and little transparency. Moreover, the lack of overlap between the opening hours of payment infrastructures in the different countries further increases end-to-end processing times. At the policy and regulatory level, anti-money laundering (AML) measures and know-your-customer (KYC) processes remain a considerable challenge, especially across borders. Different jurisdictions have different standards, impeding automation and requiring manual intervention. This drives up the costs and processing times of payments. Furthermore, growing AML and KYC requirements have led to de-risking, resulting in a decline in correspondent banking relationships. This has reduced competition and prolonged some payment chains. Payments to countries in crisis areas have become significantly harder.

These frictions affect various transaction types, payment instruments and geographical channels differently. While B2B transactions via highly used channels (e.g. between the USA and the UK) as well as credit card payments work relatively well, remittances, consumer and small business payments work less efficiently or have to rely on closed-loop solutions. For example, while the costs for remittances to sub-Saharan Africa continue to slowly decline, reaching 8.2% of the transaction value, they remain significantly above the UN sustainable development goal of 3%. While it is probably unrealistic to expect a uniform user experience across all channels and instruments, the goal should be to reduce the underlying frictions to make all cross-border payments more effective, including to those countries with a relatively low level of financial inclusion. Global coordination is key to addressing many of these frictions. That is why the G20 started work on a roadmap to enhance cross-border payments in 2019 and published the finished roadmap in 2020.

Frictions in cross-border payments require a firm, consistent and timely global response.

At the infrastructure level, one of the goals of the roadmap is to maximise overlap between the opening hours of payment systems, potentially speeding up processing times. Furthermore, it is vital to encourage interlinking between payment platforms across borders, either via bilateral links, or via multilateral platforms that interconnect multiple countries. While the former may seem more feasible at first, the latter may be more effective in addressing the frictions in the backend of cross-border payments.

For both solutions, the emergence of modern and easily accessible instant payment systems in various countries could create an opportunity. However, even payments in modern infrastructures require thorough AML/KYC checks during the process. Harmonising these requirements globally would ease some of the burden on cross-border payment providers. Harmonised KYC standards paired with a standardised payment message based on ISO 20022 could enable automated straight-through processing of cross-border payments, improving speed and potentially reducing the costs of cross-border payments. These common standards could be accompanied by technical solutions that enable data exchange across borders.

Data protection regulations may hinder data sharing between jurisdictions, leading to the idea of a KYC identity scheme, which does not share specific KYC data, but rather shares whether the payer or payee has been KYC checked. New technologies like DLT could help realise ideas such as these. Furthermore, central banks worldwide have started looking into central bank digital currencies (CBDCs). These could be a chance to start with a clean slate. When building the new CBDC infrastructures from scratch, it is therefore important to keep the international dimension in mind. Apart from technical aspects, there might also be the need to develop a framework for CBDCs to ensure global interoperability.

To sum up: there are a number of aspects and opportunities to make cross-border payments more effective – each a challenge to be tackled on a global scale. But it is of utmost importance to use the current political momentum to improve cross-border payments while relying on the trust of official central bank-issued currencies.

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Settlement risk: addressing the key issue in cross-border payments

Cross-border payments involve the settlement of an FX transaction which requires payment of one currency for receipt of another. One of the main risks in such transactions – settlement risk – is that one party delivers the currency it sold but does not receive the currency it bought, resulting in a loss of principal. Such a loss may be manageable if the amount is small. However, today's global FX market is the largest financial market in the world with an average daily volume of USD6.6 trillion.[1]

FX settlement risk is on the rise and may be reaching levels that threaten global financial stability, following an increase in global trading of currencies that do not have access to payment-versus-payment (PvP) settlement mechanisms. This has resulted in a heightened focus on overall risk management in cross-border payments, with both the public sector and market participants calling for greater adoption of PvP as the optimum solution to mitigate FX settlement risk.

To better understand settlement risk for currencies that are not currently eligible for CLSSettlement and how FX trades are settled in those currencies, CLS is working with its global settlement members to analyze their settlement activity. The results will provide further transparency on settlement behavior and enable CLS to contribute findings towards key policy initiatives. Collaboration between the public and private sectors is essential, and through two public policy initiatives, in consultation with the private sector, the industry is making great strides in this area.

The first is the Committee on Payments and Market Infrastructure's (CPMI) request for input on improvements to existing payment infrastructures and arrangements to enhance cross-border payments. This led to an initiative to encourage PvP adoption in the FX market through the inclusion of building block 9 of the Financial Stability Board's (FSB) "Enhancing Cross-Border Payments Stage 3" roadmap.

The second is the three-year review of the FX Global Code undertaken by the Global Foreign Exchange Committee (GFXC).[2] The updated Code includes amendments to the key principles concerning settlement risk, principles 35 and 50, placing greater emphasis on the use of PvP mechanisms where available, and providing more detailed guidance on the management of settlement risk where PvP settlement is not used.

CLS establishes working group to explore alternative payment-versus-payment solutions.

In response to the need to increase PvP settlement in currencies that are not currently eligible for CLSSettlement, CLS has established a working group to explore alternative PvP solutions. Initial feedback shows a strong interest in a new PvP solution and an industry pilot is underway which will evaluate the liquidity and settlement risk of potential models. While this initiative has considerable industry support and momentum behind it – 12 of CLS's settlement members have formed the working group – any new Financial Market Infrastructure (FMI) solution must prioritize safety, stability and scalability. Hence, an alternative PvP solution will require ample time for appropriate implementation.

For an FMI like CLS to deliver an optimal solution to public policy and industry challenges such as wider settlement risk mitigation, it must continually invest in its products, risk management, controls and underlying technology. This is one of the key drivers behind the completion of a significant phase in CLS's multi-year technology investment program, thereby optimizing the underlying technology platform supporting its settlement services. CLS now has one of the most sophisticated, resilient, scalable and flexible post-trade technology platforms across global FMIs, which will enable the organization to evolve its PvP offering to the requirements of the FX market.

The implementation of best practices related to mitigating settlement risk and efficient post- trade practices is a high priority for market participants, policymakers and regulators. As a systemically important FMI that operates a settlement system for FX transactions (CLSSettlement), CLS supports the industry objectives regarding mitigating settlement risk, and it is committed to raising awareness of PvP adoption more broadly.

In order to develop the optimal model to solve these industry challenges, policymakers and the private sector must engage continually with market participants. This is crucial to ensuring the market's needs are understood and that the preferred solution obtains sufficient industry investment and support. A strong public-private partnership – similar to the one that created CLS in 2002 – is required to build a successful cross-border solution to remove FX settlement risk from global financial markets.

[1] Bank for International Settlements. «Foreign Exchange Turnover in April 2019.» https://www.bis.org/statistics/rpfx19.htm
[2] The Global Foreign Exchange Committee endorsed the outcomes of the Code review on 28 June 2021 FX global code: A set of global principles of good practice in the foreign exchange market (globalfxc.org)

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Cross-border payments - Bordering aspirations with reality

For the last 150 years, Western Union has been at the forefront of delivering fast, secure and efficient cross-border payments across the globe. Drawing on the latest available technology and our network of partners, we ensure customers can transfer and receive funds instantaneously even when there is no other infrastructure in place. At the origins of our company were telegraph poles. Now we have embraced mobile and digital solutions.

In delivering our services, we at all times need to reflect the needs and realities of our customers. Less than a third of the population in developing countries has access to the internet. Only 64% of the inhabitants of least-developed countries own mobile phones. At least 450 million people have no access to a mobile signal. While technology is therefore important, payment solutions need to cater to all their customers, including with cash payments. Any international debate on the future of cross-border payments needs to reflect this diversity of customers and the importance of financial inclusion.

Western Union welcomes the G20 roadmap to enhance cross-border payments. The proposed CPMI building block approach identifies the right set of barriers and opportunities. The challenge will be to implement the recommendations in a way that is consistent with the realities of customers' needs. Rather than a 'one-size-fits-all-approach', the implementation of the recommendations will need to reflect the characteristics of the respective market, such as the remittance market in which Western Union operates.

Let me give you a number of examples:

- The recommendations should recognize the uniqueness of the customers. Payment providers should be in a position to offer the wide range of services to their customers, including those that do not have access to basic infrastructure and rely on cash payments.
- One important criterion is the cost of payments. Other key criteria for determining the effectiveness of cross-border payments should include the customer experience in relation to access, convenience, speed, trust and choice of payment solutions and providers.

Rules and regulations should not restrict innovation, nor should they favour one payment solution over another.

Regulators could take a number of other actions. The increased anti-money laundering requirements (AML) are imposing higher costs on the payment sector. One example of this is bank de-risking. Driven by the lack of regulatory certainty of the AML rules, the decision of banks to de-risk and terminate their relationships with other payment providers reduces competition and imposes additional costs on the non-bank payment sector.

In response, Western Union would support more harmonized AML rules. This would allow payment providers to invest in new compliance solutions, such as e-KYC and e-ID instruments, recognizing AI-powered approaches to AML compliance, as well as streamlining the reporting requirements by introducing common templates and machine-readability. Western Union is excited about the European Commission proposals to turn parts of the current 5th AML Directive into a Regulation and to also increase the day-to-day enforcement capabilities of the EU.

More generally, Western Union welcomes the work by CPMI to align regulatory and supervisory approaches, promote the interoperability of payment infrastructures and contribute to standard setting on data exchange. While recognizing the importance of local rules, regulations and consumer protection requirements, these should not fragment the global payment market and prevent providers from delivering efficient customer solutions. As already mentioned, rules and regulations should not restrict innovation, nor should they favour one payment solution over another.