CROSS-BORDER PAYMENTS AND GLOBAL INFRASTRUCTURES

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Working together for more efficient cross-border payments

Three years have passed since work on the G20 roadmap for enhancing cross-border payments began. After taking stock of the current cross-border payments landscape in the first phase of the work and then identifying key areas for improvement in the second, the time has now come to take up work in the key areas that have the best chance of significantly improving payments across borders. During this current phase, the involvement of all market players and the public sector is necessary to ensure the best possible outcome for all stakeholders.

First, the public sector has to work on regulatory harmonisation, including harmonisation of oversight and regulatory frameworks. With a harmonised regulatory landscape, straight-through processing of cross-border payments could be made substantially easier. In the end this could significantly improve speed and lower costs. However, it is important to promote an efficient legal, regulatory and supervisory environment for cross-border payments without compromising their secure end-to-end processing.

Second, operators should improve their payment system services – especially regarding opening hours and access – and aim to interlink with other payment systems. Thanks to the emergence of fast payments, 24/7/365 payments are becoming the norm, so adjustments to the opening hours of RTGS systems may be necessary. Furthermore, the extension of operating hours could help to increase or create overlap between settlement systems, therefore helping to improve the settlement speed of payments transmitted across multiple time zones.

In order to improve cross-border payments, market players and the public sector must act together.

Regarding the interlinking of payment systems – especially for faster payment systems, there are a couple of interesting projects on the way. For example, Project Nexus aims to interlink fast payment systems to shorten transaction chains, therefore lowering costs and increasing the speed of cross-border payments. In the future, interlinking CBDCs could further enhance the efficiency of cross-border payments. Projects like "Icebreaker" (for retail CBDCs) and "Jura" (for wholesale CBDC) could provide a window into how the future may look. However, it must be ensured that risks (e.g. contagion risks or operational risks due to the use of new technology) are properly mitigated before further increasing the integration of the global payment landscape.

Third, payment messages should be harmonised and exchanging data across borders should be made easier. More and more countries are switching to the ISO 20022 standard (with the Eurosystem adopting the standard for its T2 platform on 20 March this year); however, there are still different national and regional implementations and market practices in place. These differences as well as different data protection laws are inhibiting data exchange across borders, which in turn could hamper anti-money laundering procedures and customer due diligence checks.

Even harmonised payment areas like the Single Euro Payments Area could profit from the G20 work on the roadmap. While SEPA is already deeply integrated and cross-border payments in euro within Europe are for the most part very efficient, consumers and businesses in SEPA could benefit from more efficient payment channels to the rest of the world. Furthermore, the work on the roadmap offers the opportunity to improve existing payment infrastructures, for example by adapting to standardised APIs as laid out by the work on Building Block 14 of the roadmap.

In order to make the vision of the G20 programme work and to achieve its targets, involvement of all stakeholders is necessary, thus ensuring that implemented improvements cover a wide range of interests and market and consumer needs are met. Regulators have to work on harmonising regulation, central banks and other infrastructure providers may have to improve and interlink their systems and banks and non-banks have to actively participate in and shape the discussions – in addition to adjusting their internal systems to possible changes. This is why the G20 seeks to offer a platform for a multitude of discussions during the current stage of the roadmap. For example, the FSB's Payments Summit offers a stage for high-level discussions regarding cross-border payments, while technical experts can hammer out the details in groups like the service level task force (which seeks to enable interoperability by developing a common understanding about service level agreements) and the expert group on the harmonisation of the ISO 20022 standard.

Last but surely not least, it is important to monitor the progress in taking actions with regard to the roadmap. This is carried out via key performance indicators related to the 11 targets for cross-border wholesale, retail and remittance payments. To ensure sufficient data quantity and quality, all stakeholders have to contribute. This way, we can all work together towards a common goal: cheaper, faster and more transparent cross-border payments.

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Enhancing cross-border payments – where are we now?

Three years into the G20 Roadmap, the focus is now on moving from exploration to execution. Isabel Schmidt shares her insights on progress and the focus for the future.

Removing long-standing frictions in x-border payments will bring wide-spread benefits– supporting economic growth, international trade, global development, and financial inclusion. In turn, efforts to unlock faster, cheaper, more transparent, and inclusive x-border payments have become a truly global priority.

To tackle this, the Financial Stability Board (FSB), the Committee on Payments and Market Infrastructure (CPMI) and its partner bodies developed "The Roadmap for Enhancing Cross-Border Payments" to engage actors across the public and private sectors.

With the full backing of G20 Leaders, the first two years of the roadmap focused on assessing the existing landscape and identifying ways to improve it. In October 2022, the FSB published the next phase, focusing on three key themes: 1) payment system interoperability, 2) legal, regulatory, and supervisory frameworks, and 3) data exchange and message standards.

Improving interoperability

Efforts are being made to drive interoperability by interlinking payment market infrastructures, which can help to shorten transaction chains, reduce costs and increase the transparency and speed of payments.

The Immediate Cross-Border Payments (IXB) pilot project, for example, plans to connect real-time payment systems in the US and Europe to facilitate instant x-border payments. Key domestic payment systems – such as SEPA– are also being extended, with the aim of fostering competition and driving innovation.

While such progress is promising, these efforts do raise questions around scalability, as well as technical feasibility. For example, if 20 markets were to be interlinked, as many as 400 point-to-point connections would need to be built – and there is significant complexity and cost constraints associated with that.

One potential way forward is to build hubs that interlink payment systems – either one to many or many to many. The Bank for International Settlements (BIS) is driving progress on this front with Nexus, and it is likely that Swift will play a role going forward.

Collaboration is essential for the roadmap to be a success – and it cannot succeed without the support of both public and private parties.

The first pillar of the roadmap is also focused on supporting the extension of RTGS operating hours. FIs in the US, for example, currently operate on a 22/5 model – with the Federal Reserve Banks set to soon take this one step further by moving to a seven-day accounting cycle. While it won't be without its challenges, extending operating hours in other markets may help to eliminate payment delays, reduce settlement risk and improve liquidity management. The implications go beyond the operations of core payment systems to include areas such as liquidity management and FX markets.

Developing frameworks

There is evolving clarity regarding the legal, regulatory, and supervisory environment for x-border payments – creating uncertainty for payment actors and potential delays.

One example is the sometimes-inconsistent implementation of anti-money laundering (AML) and counter-terrorist financing controls across jurisdictions, which can introduce frictions that hinder efforts to improve x-border payments.

The roadmap is promoting the use of technology for AML/CFT, with a strong emphasis on ensuring data privacy, as well as consistent management of cyber and technology risk to keep the global network safe from bad actors, but progress is highly dependent on active engagement and alignment of policy makers and implementing bodies. Considering geopolitical dynamics, progress could be achieved through the concept of "safe corridors", as suggested by the roadmap.

Harmonised standards

As of March 20, the Swift network went live with a new global messaging standard, ISO20022. While the industry has made significant progress on aligning to a global standard and creating a strong foundation for interoperability, inconsistencies remain. Even within the context of a single set of Usage Guidelines for x-border Payments (CBPR+), ISO20022 is being interpreted and used differently – leading to manual intervention and payment delays. Similarly, while many payment infrastructures are now using the ISO20022 standard framework, the versions are not consistent, and interoperability is a challenge for players that participate in multiple networks.

In support, the CPMI recently released a consultative report on how the adoption and use of ISO20022 for x-border payments can be harmonised.

Down the road(map)

While there is a general sense of optimism at the developments, there is concern about the amount and scale of change. With so many different schemes underway, there is a potential risk of fragmentation – and effort is required to manage this. Collaboration is, therefore, essential for the roadmap to be a success – and it cannot succeed without the support of both public and private parties.

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Measuring PvP success in addressing FX settlement risk and remaining challenges

Arguably, the most important success factor for the FX market is addressing the risk of loss of principal (or settlement risk) effectively. Payment-versus-payment (PvP) mechanisms like CLSSettlement have supported FX market growth by mitigating this risk for the currencies they settle, while also delivering substantial benefits such as liquidity optimization and operational efficiencies. CLS's robust PvP settlement service has helped enable market growth, and FX turnover has multiplied by a factor of five since CLS went live in 2002.

As a result, CLSSettlement volumes have grown steadily with average daily values settled exceeding USD6.5 trillion in H12022. Much of this growth is from 30,000 indirect participants, including the buy side, that access CLSSettlement through its 70+ members, which comprise the world's largest financial institutions.

Being a critical service provider to the FX market, CLS must be proportionately resilient to its key role as a global financial market infrastructure. CLS has a strong track record of service provision and has continued to invest heavily in cybersecurity, risk management and controls and its underlying technology to ensure it meets the highest levels of operational resilience.

In recent years, policymakers and regulators have renewed their focus on FX settlement risk. Specifically, they are concerned about sectors of the market where PvP is unavailable, particularly in emerging market (EM) currencies. CLS fully supports wider adoption of PvP and applauds the efforts of the Global Foreign Exchange Committee, whose FX Global Code encourages its use, as well as the Financial Stability Board's Cross-Border Payments Roadmap, which has a dedicated building block to further PvP adoption.

To better understand settlement risk, CLS, in collaboration with its members, analysed multiple member banks' trades to determine how they were settled, to provide a good indication of the market's management of settlement risk and the range of mechanisms used to settle FX flows.

The analysis showed that of the FX transactions eligible for CLSSettlement (which comprise 80% of all FX transactions)[1], on average 51% of the traded notional is settled through CLSSettlement, while much of the remainder comprises inter-branch and inter-affiliate trades (35%) or trades where settlement occurs via a single currency cashflow or over accounts within the banks' direct control (together, 8%). This leaves around 6% of trades exposed to settlement risk that could be settled via PvP in CLSSettlement, primarily comprising smaller trades across multiple corporates and funds that do not trade high volume.

Addressing settlement risk effectively has been largely achieved for CLS-eligible currencies.

CLS's findings are complementary to – but not directly comparable to – the BIS Survey, which showed that the share of FX transactions settled without PvP is one fifth of the market (including the 6% mentioned). The BIS Survey scope is wider and includes both CLS-eligible and -ineligible currencies, EM currencies in the main that have seen significantly increased trading volumes in recent years.

The 6% that could be settled via PvP is the target of CLS's efforts to increase adoption of CLSSettlement. Addressing settlement risk beyond CLS-eligible currencies may require an alternative solution. Given its systemic importance, adding new currencies to CLSSettlement is an extended effort that is subject to several requirements, including ongoing support from the central banks on both sides of the currency flow and in some cases changes in the target jurisdiction's laws and regulations.

Given these complexities, CLS is exploring several avenues to expand PvP coverage, including a possible new PvP service for certain currencies. However, geopolitical factors have led CLS to reassess the pace at which this moves forward. For now, CLS is focusing on growing CLSNet, its automated bilateral payment netting calculation service for over 120 currencies.

CLSNet already helps to mitigate operational risk associated with trading EM currencies. It supports netting to reduce the payment obligations exposed to settlement risk while improving operational and liquidity efficiencies. The majority of the interbank transaction flow through CLSNet is in the deliverable EM currencies that pose the most settlement risk for CLS's members. As a result, the flows in CLSNet increased exponentially over the course of 2022 and have continued to increase in 2023.

Successful settlement risk mitigation has been largely achieved for CLS-eligible currencies. But with the growth in EM currency trading, the remaining challenge is how to achieve settlement risk mitigation for currencies ineligible for PvP settlement. For these currencies, until a new PvP solution can be developed, mitigating operational risk, optimizing liquidity and creating operational efficiencies through a centralized, standardized and automated process, like CLSNet, is the industry's preferred approach.

[1] 2022 BIS Triennial Central Bank Survey of FX and OTC derivatives markets (BIS Survey).