

COMPLEMENTARY OR COMPETITIVE? THE ROLE OF PAYMENTS MARKET INFRASTRUCTURES (PMIS) AND CORRESPONDENT BANKS IN INSTANT INTERNATIONAL PAYMENTS

By Lisa Lansdowne-Higgins, Vice President, Business Deposits and Treasury Solutions, RBC

Payments across borders remain slow, opaque and costly by comparison with their domestic equivalents, but this reflects the realities of servicing transactions which are intrinsically more complex. Nevertheless, by working together in flexible and complementary ways, and sharing responsibility for the outcome, payments market infrastructures and banks have an opportunity to collaborate to increase the efficiency of international payments.

Payments are an everyday occurrence. The World Payments Report 2017 counted 433.1 billion of them in 2014-15¹. On a peak day, SWIFT will record more than 30 million FIN messages, half of them payments messages. Payments systems clearly work, even across national borders. But it would be a mistake to think that, just because value can be moved seamlessly between accounts all over the world on such an enormous scale, making a cross-border payment is a simple process.

Even an instruction to move money from the account of a paying customer in one country to a receiving customer in the same country triggers a number of inter-connected and inter-dependent processes, between customers and payment channels, between payment channels and banks, and between banks and payments market infrastructures (PMIs). Like the gears in any machine, the various cogs in the payments machine must fit together perfectly at exactly the right time, or none of this work can be done.

Cross-border payments introduce several further layers of complexity. Different countries use different currencies, necessitating a foreign exchange transaction in each currency pair. The banks on either side of this exchange are regulated separately. Each jurisdiction has its own laws, regulations and reporting requirements governing payments. The payments banks in each jurisdiction also adhere to business rules, technical standards, market practices and privacy requirements specific to that jurisdiction.

The relationship of a correspondent bank with its varying partner bank relationships has evolved to manage these complexities. The solutions developed continue to put the needs of their global counterparts and customers front and centre. As the global landscape

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¹ CapGemini and BNP Paribas, *World Payments Report*, 2017.

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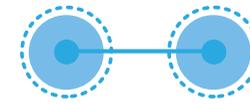
Multiple factors complicate cross-border payments

Envisioning a global exchange of real-time payments, it follows there is an opportunity for correspondent banks and PMIs to work together to reduce the cost and complexity and accelerate the speed of cross-border payments. In mapping how that can be done, it helps to paint a comprehensive picture of the issues which affect and constrain the efficiency of cross-border payments. As the diagram shows, they fall into five categories: business-related risks, client demands, technical infrastructure, regulatory requirements and elements specific to cross-border transactions.

The list of factors in the diagram is not exhaustive. But, it provides a useful breakdown of the complexities surrounding cross-border payments, the links between them, between them and the correspondent banks, at the local, the regional and the global levels. It is a potential area of focus for PMIs to mitigate, reduce or eliminate any of the factors itemised, knowing it could improve the entire eco-system of cross-border payments. There is a view they are well-placed to do so, for two reasons.

Neither PMIs nor banks can solve the complexities alone

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Cross-border payments: considerations and constraints

Payments Business-related Risks

- Liquidity
- Settlement
- Operational risks
- Profitability / Operational efficiency
- Competition

Client Demands

- Transparency
- Speed
- Certainty
- Reduced cost
- Ease of use (e.g. proxy routing)

Technical Infrastructure

- Technical (scheme) standards
- Inter-operability of payment systems (or lack thereof)
- Technology adequacy (or lack thereof)
- Cyber-security (including tokenisation)
- Digital identity management

Regulatory Requirements

- AML / ATF / CFT
- KYC
- Sanctions screening (where applicable)
- Regulatory reporting, including intra-day where applicable
- Privacy

Cross-border Elements

- FX and currency risk
- Political risk
- Reputational risk
- Cross-jurisdictional risk

Attend Lisa Lansdowne-Higgins's session at Sibos:

Complementary or competitive? The role of payments market infrastructures and correspondent banks in instant international payments

Conference room 3
Tuesday 17 October 2017
14.00-15.00

Moderator

Lisa Lansdowne-Higgins

Vice President, Business Deposits
and Treasury Solutions, at RBC

Panelists

Andrew Brown

Chief Risk Officer, Earthport plc

Michael Bellacosa

Director of global payments, BNY
Mellon

Leila Fourie

CEO, Australian Payments Network

Michael Steinbach

CEO, EquensWorldine

have a wide impact. It will be key for PMIs to focus on areas which make the biggest difference in the market. In some, that might mean reducing settlement risk. In others, it might mean enhancing inter-operability of payments systems, or addressing lack of harmonisation of standards.

At the same time, common prudence - let alone sound risk management practices - might argue against allowing PMIs to shoulder the burden of solving all the problems. Their appetite for assuming currency risk, for example, would be limited. They do not provide foreign exchange services and taking on the operational challenge of sanctions screening may be out of reach for some.

This is where complementarity between PMIs and correspondent banks becomes meaningful. By adaptations to the technical infrastructure, PMIs have the opportunity to reduce risks, potentially foster innovation and meet the demands of customers and regulators, but balancing where best to solve these challenges is critical. On the other hand correspondent banks in particular will need to re-assess, re-invent or re-position their key payment strategies aligning with their customers' needs in the markets they serve, including how they provide liquidity, screen customers and deliver new and innovative solutions to the market.

Flexibility is required to keep up with the complexities

That re-assessment or re-invention or re-positioning is not, of course, a one-off exercise. The relative importance and impact of the issues listed in the diagram will change over time. Some will fade away completely, while the pressure from others will amplify as time passes. Entirely new issues will emerge, as society and technology evolve. Wider trends in the banking industry, ranging from regulatory

requirements to disruptive new entrants, will also affect cross-border payments.

In addition, any adaptations made by PMIs or correspondent banks are inevitably subject to the unpredictability of the future. Changes made in one process, or in a single location, will have downstream impacts which are impossible to predict. These are likely to create fresh forms of friction in the area of payments. The tools available to clear these obstacles will also change, as the power and capacity of digital technology continues to increase.

The challenge facing PMIs and correspondent banks is to remain flexible enough to overcome the constraints on the efficiency of cross-border payments as they mutate over time. That flexibility could extend to shifts in the balance of responsibility for safe and successful cross-border payments between PMIs, correspondent banks, banks, other incumbents and new entrants. And, as the distribution of costs and rewards in cross-border payments changes, so could accountability for the outcome.

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