Coexistence and collaboration in a cross-border world

2022 represents a critical juncture for the payments industry as its evolution towards ISO 20022 reaches an important milestone in November


Thierry Chilosi, head of business development, Europe, Swift


Marc Recker, global head of product, institutional cash management, Deutsche Bank

As the November 2022 start date for migration to ISO 20022 cross-border payments and reporting looms, Swift is "cautiously optimistic" that its users will be ready for the three years of coexistence between old (MT) and new (MX) messaging formats.

"Eighty per cent of our community has installed the required software to be able to receive ISO 20022 messages," says Thierry Chilosi, head of business development, Europe, Swift. "Those that want to send ISO 20022 messages can do so immediately as of November and everybody else can process them."

The caution arises from the amount of testing that remains, he adds, as well as the 20% of "very much engaged" Swift members who are yet to complete their migration.

"November is a very important milestone and the majority of the Swift community will start to get more experience of what ISO 20022 is and, more exciting, will be able to start building on top of ISO 20022, which provides a foundation on which to innovate."

Marc Recker, global head of product, institutional cash management, Deutsche Bank says there will be differences in the ISO 20022 migration across the world. In Europe, for example, it will be mandatory for all European banks that are direct participants in financial market infrastructures such as Target and Euro1 to use the new standard. "Globally, some of our client banks have embraced ISO 20022 immediately, while others may take a bit longer."

SWIFT GPI CONTINUES TO EVOLVE

Migration to the new ISO 20022 standard is just one of a range of issues banks face in cross-border payments. The interlinking of instant payment schemes, blockchain and cryptocurrencies are transforming the cross-border payment business.

During the past five years, improvements in the transparency, tracking and predictability of cross-border payments have been made by Swift based on the GPI service, which was introduced in 2017. Since then the service has been developed further, with Swift Go launched last year.

Developed to improve services for small business customers that make lower value cross-border payments, Swift Go gives participant banks information on the amount of funds a beneficiary will receive and when they will receive it, along with any FX details before the payment is sent. This is achieved via bilateral, agreed fees between Swift Go participants that are maintained in a Swift central reporting engine.

"Swift Go builds on the transparency the correspondent community gained on cross-border payments via Swift GPI," says Joanne Strobel, head of CIB segment solutions, global treasury management at Wells Fargo. "The transparency gained on cross-border payments as a result of Swift GPI was a game changer for correspondent banks. But we knew we couldn't stop there and should drive further value out of the GPI infrastructure to improve the cross-border payment experience for our end customers."

GPI delivered post-payment transparency, while Swift Go delivers similar information at the front of a cross-border payment transaction. "Bringing the information upfront has delivered predictability to lower value cross-border payments," says Ms Strobel.

More than 100 banks have signed up to Swift Go, although many are still testing before going live. Mr Recker says there is a "clear demand" for the service among Deutsche Bank's SME clients. "Clients want to use their bank account for efficient and secure cross-border payments. The potential of Swift Go is the reach of the Swift network. Competing systems are focused on closed loop, or limited corridor services, whereas Swift Go leverages the existing correspondent banking network and that is a big differentiator."

Ms Strobel says Swift Go is "a very impor-

Joanne Strobel, head of CIB segment solutions, global treasury management, Wells Fargo

Matt Loos, head of corporate development strategy and market intelligence, Swift

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tant step" to provide upfront predictability on cross-border payments, but there is "still more work to do". This work includes expanding country corridors and currencies and integrating real-time payment infrastructures. "I believe that we also need to consider expanding Swift Go to be interoperable with a variety of payment rails, networks and channels to provide a consistent and predictable end to end experience for our small business clients," she says.

In striving towards faster payments transactions, interlinking real-time, or instant, payments infrastructures across borders is now required, says Matt Loos, head of corporate development strategy and market intelligence at Swift.

"My gut tells me there will be different models and ways to do this, he says. "We need to figure out how to bring the speed achieved in domestic faster payments systems into the cross-border world. One of those models is interlinking."

Swift has been working with The Clearing House and EBA on interlinking the real-time payment systems of the US with that of Europe, completing a proof of concept in 2021, he adds. Such a link will give banks that are members of one domestic faster payments system the ability to link to others in real time.

Bernd Waizenhoefer, head of clearing products, institutional cash management, Deutsche Bank, says interlinking means banks won't have to invest in a completely new multi-country clearing infrastructure on top of existing domestic systems. "We won't have to run these systems in parallel or maintain them in parallel but can focus on the simplicity of a single infrastructure, which is much easier and cost efficient for banks," he says.

Before characterising the interlinking of faster payments infrastructures as a "breakthrough", Mr Waizenhoefer says some questions must be answered. "We have to look at the use case and understand where payments are sourced from and what kind of payments they are. Do we focus on new payment wallets, which are not part of the banking universe, or do we refer to the payments that are already processed by banks within commercial payments processing, which today is already highly efficient?"

Mr Loos adds that as time goes on, every country will likely have their own domestic real-time payments system, and it will be very expensive and inefficient for every bank to have to connect directly to every one of them. "That's not realistic, so the opportunity to link the US and Europe and by the end of 2023 to scale it up to a system that can process transactions across the US and Europe is very exciting. From there, we'll look to how we can connect to other real-time systems in the UK, Canada, etcetera using the same model and creating rules that will be very efficient for members in one domestic system to access other real-time payment systems around the world."

GEARING UP FOR DIGITAL CURRENCIES

In the same way as interlinking instant payment systems is an option for improving the efficiency of cross-border payments, the banking industry is also looking into the potential of digital currencies.

Whether central bank digital currencies (CBDCs) can solve some of the pain points of international payments – for example by the reduction of high transaction costs, further increasing transparency and shortening of settlement times – depends on the type of CBDC, says Manuel Klein, product manager blockchain solutions and digital currencies at Deutsche Bank.

"There are discussions around the introduction of retail CBDCs for every market participant, and wholesale CBDCs for the interbank market only. We, at Deutsche Bank, see most advantages in the wholesale area", he says. At present, CBDCs alone won't reduce the largest cost-driver, which is mainly attributed to compliance checks like KYC, AML, CFT and Sanctions-Checks. Regarding a reduction of costs attributed to transaction fees, it remains to be seen whether wholesale CBDC transactions that combine messaging and settlement will reduce transaction costs. However, there are clear advantages to be realised in higher transparency, 24/7 availability and the fact that there is no need for reconciliation between different payment systems and data silos. "Reconciliation costs could be reduced quite substantially if banks used distributed ledgers for cross-border payments because there is only one single source of truth."

Wholesale CBDCs could also ease access to central bank money and offer various benefits in capital markets like atomic settlement or "Delivery vs Payment" which were demonstrated in several pilot transactions, where security tokens have been issued and settled against a wholesale CBDC. "In the eurozone, the "DLT Pilot Regime" will go live next year which enables multilateral trading of security tokens that are ought to be settled against a wholesale CBDC", says Mr Klein. Additional benefits are the reduction of risk weighted assets due to settlement in central bank money rather than commercial bank money in different nostro accounts. Additionally, consolidating the different nostros into a single source of liquidity provides the potential to reduce liquidity buffers.

Stablecoins may find a place in cross-border payments but it will depend on how they are structured and regulated , says Mr Klein. It remains to be seen how companies that offer services around stablecoins will incorporate anti-money laundering checks and other compliance processes. One disadvantage of using stablecoins is that they operate in a closed-loop system which requires widespread acceptance of these tokens. "Our view at Deutsche Bank is that a multi-bank capable solution should be introduced, whereby deposits could be transferred via blockchain as well."