ORLANDO MAY 5-8, 2024

2024 BAFT Global Annual Meeting

BUILDING BRIDGES AMID A CHANGING GLOBAL LANDSCAPE

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Future Leaders Presentation:

Roadmap to Modernizing Wholesale Cross-Border Payments under Today's Correspondent Banking Model

Future Leaders Program 2024

Payments Team

May 6, 2024

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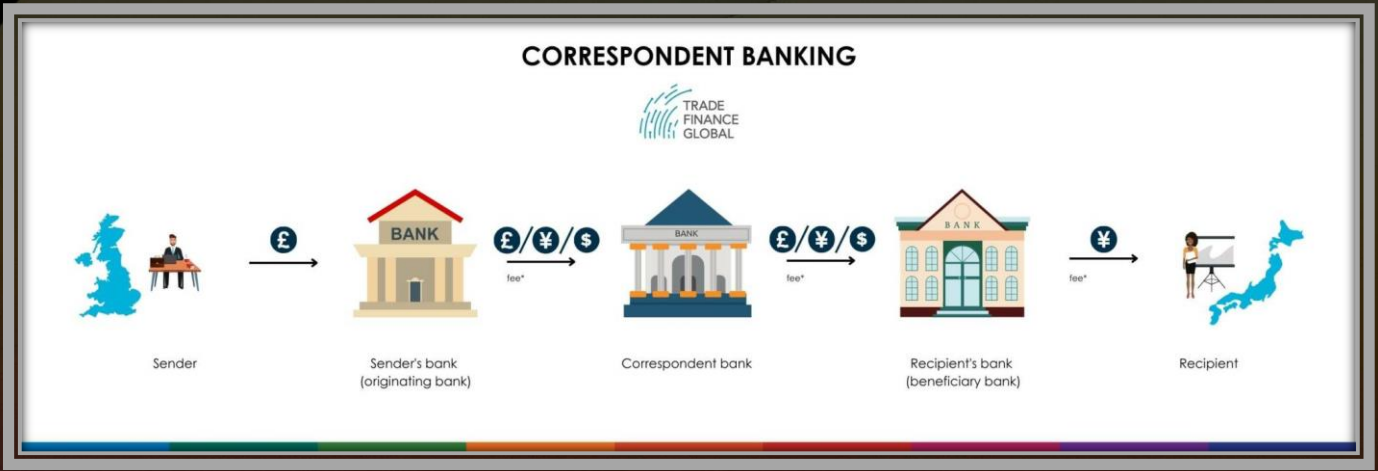
Introduction

Wholesale Cross-Border Payments

For decades, correspondent banking has been the central mechanism for cross-border payments. In today's presentation, "payments" refer to wholesale payments sent by financial institutions that are generally larger in size and are often bulk payments to a bank's own nostro account to cover multiple transactions for the bank's underlying customer.



Customer Expectations

- Faster
- Cheaper
- More transparent
- Safer

Instant Money Movement

Forward Looking

- Correspondent banking modernization
- Emerging alternative payments (e.g., Fintech)

Main Challenges in Wholesale Cross-Border Payments

Main challenges presented in wholesale cross-border payments concentrate on the following 5 aspects and encourage us to consider emerging alternative payments and sync up the efforts with correspondent banking.

Reach & Speed

- Two-fold hurdle: payments from originating bank to beneficiary bank & payments from beneficiary bank to customers
- System interconnectivity requiring constant technology support

Cost

- 25% of country corridors have avg costs that exceed G20 Payments Initiatives target (<= 3%)

Transparency

- Easy to conceal ultimate beneficial owners
- Challenging to gain full transparency of payments' cost breakdown, timing & location

System Interconnectivity

- Costly to maintain inter-communication and interoperability among systems

Security

- Data breaches, fraud and identify theft

International Standards and Regulatory Context

Global Standards for Data Syntax and Semantics

ISO20022 is the agreed methodology used by financial industry to create consistent message standards across all business processes of the industry.

1 Top layer – business processes and concepts

- ISO 20022 methodology starts with the creation of the business model (activity/business process, business roles/actors, business info)
- Business info is organized into business components containing business elements

2 Middle layer – Logical data models and flows

- A logical model is a description of all the info that is needed to perform a specific business activity, independent of syntax
- A logical model is composed of message or data components organized in a hierarchical structure
- ISO 20022 enables the reuse of business and message components across all messages and API resources

3 Bottom layer - Syntax

- ISO 20022 uses XML and specifies how to convert a message model to XML
- In particular, business domain, a message model could be expressed in a syntax different from XM (e.g., the SWIFT proprietary syntax or the FIX syntax, if agreed)

By the end of 2025, ISO 20022 will likely become the standard for global cross-border payments. ISO 20022 can not only interoperate with other standards, but also further facilitate interoperability by acting as an interoperability hub.

Financial Action Task Force (FATF)

The FATF leads global action to tackle money laundering (ML), terrorist and proliferation financing.

1 FATF established global standards to combat ML and terrorist financing in payments

- FATF promotes global standards to mitigate money laundering, terrorist and proliferation financing risks
- Recommendations 16 (wire transfers) and 24 (beneficial ownership) provide global standards for payments

2 Required information for wire transfers in cross-border payments

- Financial institutions (FIs) should include required originator and beneficiary information on wire transfers
- FIs should monitor wire transfers to detect those that lack required information and take appropriate measures

3 Beneficial ownership is key information in cross-border payments

- FATF revised standards on beneficial ownership to ensure greater transparency on the ultimate ownership and control of arrangements and to mitigate the risks of their misuse
- Countries should follow a risk-based approach and ensure for public authorities have access to beneficial ownership of legal persons

For cross-border payments, the FATF established the global standards for countries to implement. With regards to the Anti-Money Laundering (AML) and Counter Terrorist Financing (CTF), each country has its own regulatory requirements and supervisory frameworks.

The G20 Payment Initiatives

The G20 Payment Initiatives

The Roadmap for Enhancing Cross-border Payments is a priority initiative of the G20. 3 priority themes and 15 actions are created to achieve the G20 targets.

Tackle challenges: high cost, slow processing speeds and insufficient transparency and accessibility

Payment system interoperability and extension

1. Central bank operators community of practice
2. FPS interlinking across borders
3. Cross-border payment service level agreement/schemes

Legal, regulatory and supervisory frameworks

4. Bank/Non-Bank regulation and supervision
5. Information to end-users
6. AML/CFT rules application

Data exchange and message standards

7. Interaction with data frameworks
8. ISO 20022 harmonization requirements
9. API harmonization
10. LEI use

Overarching actions across themes

11. Payments Summit
12. Industry taskforces
13. Monitoring and progress reporting
14. Technical assistance
15. Public sector outreach

Emerging Alternative Payments

Distributed Ledger Technology

Distributed Ledger Technology (DLT) has been providing new solutions to the cross-border payments landscape to reduce complexities and costs and enhance regulatory compliance.

Visa B2B Connect

- Streamline and enhance cross-border B2B transactions
- Ensure integrity and immutability of transaction data
- Real-time visibility and predictability into payment status
- Highly scalable and adaptable to evolving global needs

Fnality International

- Introduction of a new paradigm for digital asset settlement
- Utility Settlement Coin, a network of blockchain-based payment systems, enables instant, secure and cost-effective settlement of financial transactions across different asset classes and jurisdictions

Wholesale Central Bank Digital Currencies (wCBDCs)

- Digital currencies issued by central banks for use by FIs
- Streamline process for cross-border payments

Stored Value Instruments

A trend to use proxies as a beneficiary identifier for cross-border payments has emerged especially in economies in Africa, Asia and Latin America.

Project Nexus

- Connect instant payments systems across multiple countries through a multilaterally linked central platform
- Use proxy (e.g., mobile phone #, corporate identifier (instead of bank account numbers)) as proxies for transfers
- Technical framework including ISO 20022 guidelines and APIs specifications

Terrapay

- One of the world's largest and most active Fintech payment enablers with a focus on mobile wallet
- Transactions through platforms for mobile wallets are backed by mobile phone numbers
- Digital infrastructure connecting mobile wallets, banks and cards in 210 countries

Domestic and Regional Instant Payment Initiatives

There are a number of regional and domestic instant payment initiatives that could lead to major benefits for cross-border payments. These initiatives primarily focus on addressing regulatory and interoperability challenges.

EPC One-Leg Out Instant Credit Transfer

- International credit transfers
- Support the possibility of sending and receiving remittance data on a structured or unstructured basis
- Potentially improve the liquidity management for those PSPs involved

Immediate Cross-Border Payments (IXB)

- Facilitate cross-border payments in EUR and USD by connecting the European and US real-time infrastructures
- Employ a single payment service or network rather than the traditional correspondent banking network

Enhancements to Traditional Correspondent Banking

The vast traditional correspondent banking model can be improved with some simple solutions like payment pre-validation and better visibility in the payment chain. The drawback is that big players will potentially consolidate even more, leaving small institutions behind.

SWIFT GO

- Facilitate international payments with a focus on lower-value cross-border payments
- Transparency on transactional costs upfront
- Reduce cost of processing cross-border payments as it provides a common currency guide and strict network validation

SWIFT Payment Pre-validation

- Streamline the payment process, improve accuracy, and increase the overall speed of cross-border transactions
- Reduces the risk of rejected and misdirected payments due to missing or incorrect data, and helps identify instances of fraud
- More confidence (to corporates) that the payments are reaching the intended recipients

Summary View of Emerging Alternative Payments

	DLT			Stored Value Instruments		Domestic and Regional Instant Payment Initiatives		Enhancements to Traditional Correspondent Banking	
Features	**Visa B2B Connect**	**FNALITY**	**wCBDCs**	**Terrapay**	**Project Nexus**	**EPC One-Leg Out Instant Credit Transfer**	**IXB**	**SWIFT Go**	**SWIFT Payment Pre-Validation**
Launched in	2019	2020	2010s	2015	2019	2023	2020	2021	2022
Stage	Deployed	Deployed	Pilot	Deployed	Pilot	Pilot	Deployed	Deployed	Pilot
Keyword	Platform	Tokenized fiat ccys initiative	Digital currencies issued by central bank	Digital infrastructure for mobile wallet platforms	Centralized platform for Instant Payment Systems	Instant credit transfer scheme	EUR/USD currency corridor	Faster, predictable and competitively priced payment	Pre-validation database
Currencies	154	CAD, EUR, GBP, JPY & USD	130+ countries exploring	71	60+ countries	Any currency	USD / EUR	USD / GBP / EUR	-
Countries / Regions	Worldwide	Worldwide	Worldwide (domestic, intra/inter-region)	Worldwide	EU, Malaysia, Singapore	Worldwide (EURO-Leg based)	US, European Union	Worldwide	Worldwide
Intended for	Connection/ Security	Efficiency/ Simplicity	Interoperability	Digital Wallets	IPS Connections	Fast Execution	Interoperability	Transparency/Speed	Accuracy
Limits	-	-	-	Infrastructure for 10 million currently being built	-	EUR 100,000	-	USD / GBP / EUR 10,000	N/A

Artificial Intelligence (AI) in Payments

Artificial Intelligence (AI)

AI in payments will not only improve operations but also contribute to shaping a modern and innovative payment landscape. It can automate lower-value tasks while allocating higher-value activities to humans.

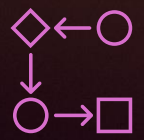
1 Benefits

- Interoperability: seamless communication amongst networks
- Enhanced Security: fraud detection, AML monitoring
- Speed and Efficiency: automation of low-value tasks
- Cost Savings: lower operational expenses

2 Challenges

- Free exchange of information: sensitive data
- Setting global standards: navigating different political landscapes
- Significant investment: is it feasible and worth it?

Two examples where AI can be used in the financial services industry:



Manual Procedures in Compliance

- Teams spend time reconciliating, formatting and double-checking spreadsheets

Decision-Making in Payments

- Teams are making recurring decisions in the payment transaction flow

Correspondent banks must carefully balance the benefits of adopting AI versus the cost of inaction. Companies that embed AI into their DNA to drive innovation, customer centricity and operational efficiency will reap the rewards.

Conclusion

Conclusion

The **modernization** of the current Wholesale correspondent banking model is an **ongoing journey** in which:

- Preserving **trust** & **network** for our clients should have the highest priority
- Achieving **compliant interoperability** (regional/global) should be the main goal
- **Collaboration** between industry players should continue to increase
  (**no single winners**: solutions depend on use-cases, market demand)
- AI has process-improvement potential for processes where **high-quality and streamlined data** exists
  (assessments on where AI adds value/diminishes value – including mitigation mechanisms)
- **Continuous change** should be welcomed
- Tech & AI **educational campaigns** should be launched (imparted by trusted institutions)

Thank you!

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