New Cross-Border Payment System

Cite
Financial Stability Board, Enhancing Cross-Border Payments: Stage 3 Roadmap

Recommended Distribution:
Payment System, Policy, Corporate Development,
Policy, Legal, Government Relations

Websites:
https://www.fsb.org/wp-content/uploads/P131020-1.pdf

Impact Assessment

- The FSB and many other global bodies have finalized a vision of cross-border payments with far-reaching implications not only for payments, but also for personal privacy, regulatory arbitrage, the role of nonbanks, cross-border resolution, monetary-policy transmission, and financial stability.
- Some of these policy consequences are referenced in this statement, but work on them is not always clearly planned or, where issues are noted, incorporated into near-term payment-system changes that on their own might have significant policy impact. Siloed focus on payment-system architecture may lead to asymmetric improvements in cross-border payment efficiency at cost to other national and global priorities.
- Remittance services could transition to less costly, more certain low-balance transactions between advanced and developing nations.
- Derisking could be reduced by new "safe haven" corridors, expanding correspondent banking and improving emerging-market economic development.
- Global regulators have committed to a public/private construct, providing opportunities for private entities some feared might be excluded.
- This plan continues the FSB's new "same risk, same rule" policy, reinforcing that nonbank payment providers will not be allowed to enjoy opportunities for regulatory arbitrage. However, it expressly states that nonbanks should gain payment-system access.

Overview

Following two initial reports, the FSB has worked with other global regulators and international financial institutions to craft a framework it hopes will enhance cross-border payments and thus improve financial inclusion, emerging-economy growth, and financial stability. Although actions and deadlines are laid out even as the FSB readily acknowledges that the plan is preliminary, its building blocks are very ambitious and often accompanied by specific deadlines to which global organizations have committed themselves. It thus appears that structural change in cross-border payments will begin later this year even as broader policy issues remain under consideration. The work program looks not only at expanding the existing payment ecosystem, but also at building a platform for new instruments such as the stablecoins addressed in a prior FSB policy statement[1] and central bank digital currency; these building blocks could integrate new digital payment technologies with ongoing efforts to improve speed, inclusion, security, and efficiency, but many obstacles to these new technologies will combine with technology and policy obstacles in ways that may distance final outcomes from the FSB's near-term expectations.

Impact

When the FSB issued its first report on the global payment system earlier this year, it identified four key concerns: high cost, low speed, limited access, and opacity. These result from fragmented data standards or lack of inter-operability, compliance complexity, different operating hours, and outdated technology platforms. The final report has concluded that the best way to address these problems is via public/private arrangements, with regulation and supervision enhanced to address private participants as well as modernize and harmonize national standards deemed essential for successful cross-border payments. Much work will also focus on harmonizing technology, operating hours, data standards, and other critical technology features.

Although the scope of some of this work may seem technical, its implications could be very far-reaching. The report notes in passing that integrated cross-border payments could create challenges to financial-institution resolution, going on also briefly to note financial-stability concerns. Problems may arise due to the ease with which operational, foreign-exchange, and other risks would likely travel to other financial and payment systems if cross-border payments become as seamlessly integrated as intended by the FSB and its partner agencies. Significant advances in other FSB concerns such as market fragmentation may need to advance in tandem with payment-system reform to support the revisions to national standards necessary to ensure that resolution plans and protocols anticipate integrated payment flows.

Another set of significant questions is raised by plans for cross-border data identifiers. Even if these are housed in proxy registries, these identifiers may create many questions about maintaining personal privacy when payment information may be accessible by non-domestic governments and/or their tax or national-security authorities. Even within home

[1] See **CRYPTO14**, *Financial Services Management*, April 23, 2020.

countries, this concept may be quite controversial – the U.S. for example has a strong aversion to government access to private financial information even in the context of domestic anti-money laundering activities such as those facilitated by beneficial-ownership reporting. The plan's work to create global AML and CFT standards is similarly ambitious and likely problematic given an array of differing national interests.

Another high-level policy question is raised by the plan's building blocks to harmonize payment standards and the APIs that access the system. Uniform protocols will certainly enhance frictionless cross-border payments, but these standards are not without complexity that often complicates establishing uniformity even within national regimes. Top-down arbitration of these technology-standard negotiations by global authorities may face resistance due to competitive concerns within nations and/or between them as well as fears that a global set of standards may be hard to change as technology continues to evolve.

The FSB standards also call for open access to payment systems under the same-function/same-rule construct. The Federal Reserve has so far resisted allowing nonbanks access to its payment system, including FedNow.[2] It has not provided a detailed rationale for this decision, but the Fed lacks statutory authority to ensure that nonbanks accessing its portions of the payment system do so under the many rules that govern banks along with the Fed's ability to supervise them. The Board has for example not even allowed OCC-chartered special-purpose fintech banks to access the payment system even though the OCC has pledged to govern them stringently.[3] Acting Comptroller Brooks now plans a special-purpose charter specifically designed for payments that might overcome Fed objections, but this is very much to be seen.

As noted, the new policy also includes a focus on new payment technologies, most of which remain in early design or even just in theory. Technologies to be assessed include new multilateral platforms, global stablecoin, and central bank digital currency (CBDC). Multilateral platforms create particularly significant policy challenges the FSB itself suggests. These include not just those related to resolvability, but also to monetary-policy transmission and financial stability. In addition, sovereign governments may be unwilling to allow such core infrastructure to move outside domestic control onto multilateral platforms unless these are subject to their law and rules for all key functions. Private consortia such as SWIFT might well win acceptance, but even that has become more uncertain in light of all the controversies surrounding sanctions, trade protections, and other aspects of cross-border commerce over the last few years.

The FSB's approach to building out cross-border stablecoins is likely to be less controversial given broad governmental support for its standards,[4] but private entities seeking to enter this arena (e.g., Libra) will surely contest them in at least some nations. The extent to which CBDC becomes a vehicle for cross-border payments is mired in many questions surrounding CBDC itself. With particular regard to cross-border payments, these could affect the extent to which the U.S. dollar remains the global reserve currency based on issues not only with regard to CBDC, but also the multilateral platforms

[2] See **PAYMENT20**, *Financial Services Management*, August 13, 2020.

[3] See **FINTECH20**, *Financial Services Management*, August 3, 2018.

[4] See **CRYPTO14**, *Financial Services Management*, April 23, 2020.

referenced above. Many privacy, tax-policy, and even national-security issues also arise if fiat currencies flow in and out of the cross-border payment system through central banks with power to trace participants in domestic payment transactions.

Despite all these high-level policy considerations, the nearest-term aspects of the FSB's program are likely to improve cross-border payments in more limited, yet still important, ways. For example, some relatively minor changes may well make it easier for migrant workers and other individuals sending low-balance payments to do so within the regulated payment system at considerably lower cost and risk. Given the importance of remittance payments to certain emerging market economies, greater speed and reliability along with lower cost could even boost macroeconomic growth. The safe-haven payment corridors discussed below could also facilitate remittances through the payment system in part by reducing or even eliminating the fears of banks with strict AML and CFT regimes when dealing with counterparties in certain nations. As global regulators have observed, "derisking" due to these fears has had significant adverse impact on some nations and vulnerable populations.

What's Next

The FSB issued this roadmap on October 13. Public consultations will proceed at key decision points. With this document in hand, the FSB will also turn to quantitative measurement criteria for progress that will be issued for public comment in May and then presented to the G20 in October of 2021. The FSB will consult on these targets and coordinate work by all participating agencies, reporting annually to the G20. Specific deadlines through 2021 are considered commitments and noted below where appropriate.

Analysis

The FSB's building-block work plan includes the following actions:

- following consultation, CPMI will identify where common features in the global cross-border payment system would alleviate friction;
- CPMI in conjunction with private stakeholders will undertake a self-assessment of cross-border payments;
- FSB will coordinate an overall review of regulatory standards, identifying areas in need of additional alignment as well as key gaps. A key objective is consistent application of AML, CFT, and KYC standards;
- a framework for payment-service agreements will be developed along with a template service agreement. FATF will also assess national KYC due-diligence standards and issue guidance for national cooperation in late 2021 or 2022. Technology advances in AML/CFT compliance will also be considered;
- FSB will review national and regional data frameworks in order to improve cross-border data flow and information sharing. Following a public consultation, specific recommendations will be issued. International technology standards will not be addressed until 2025;

- the IMF, World Bank, and other entities will look for ways to identify low-risk "corridors" for cross-border payments, issuing proposals for public comment starting next year. A pilot, voluntary program for safe-haven corridors would follow;
- an extensive project on digital identities will begin;
- an array of efforts on managing FX settlement risk will advance;
- an array of steps will begin to improve payment-system access by banks, nonbanks, and payment infrastructure, identifying impediments by April 2021. A set of best practices will also be developed followed by self-assessment protocols. Relevant agencies will also provide technical guidance from 2022 on to assist this direct-access process;
- a series of reciprocal central-bank liquidity arrangements will be assessed starting in 2020 with central banks that have started pilots in this area or are willing to do so. Global bodies will start technical advice in 2021 and assess risk and technology issues;
- payment systems and currency corridors critical to cross-border payments will be identified and work will begin to align operating hours. Risks, including those to financial-institution resolution, monetary-policy transmission and financial stability will be assessed. Future "end states" will be laid out starting early next year along with "policy statements" to mitigate identified risks;
- work to "interlink" payment systems will begin, starting with a stock-taking exercise this year with an interlinking framework to be set out in 2021. Again, "end-states" resolving technical and policy challenges are envisioned;
- a harmonized ISO 20022 using tech sprints and other actions will be developed starting in 2020;
- API protocols for data exchange will also be harmonized, again using a tech sprint and other techniques starting in 2020;
- unique identifiers with proxy registries will be evaluated by an array of global bodies starting in 2020. If this advances, FSB would determine appropriate governance arrangements while national authorities review issues in this arena in 2021;
- new multilateral platforms will be considered starting with a stock-taking in 2020 looking at public and private options, developing a global "reference architecture," and assessing the issues these may pose. An array of global bodies will then study this issue into 2023. Although proof of concept is within the scope of this project, building multilateral platforms is not;
- work will also support sound global stablecoins following the FSB's 2020 report. National authorities are to establish appropriate regulatory, supervisory, and operational protocols in 2021. FSB will then review this framework in 2023; and
- work will factor international issues into CBDC design starting in 2021. The IMF will look at macro financial considerations while numerous interlinking options are developed by CPMI in 2021. Technical questions will be assessed starting in 2022 and a conference will be held thereafter to consider all these insights.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone: (202) 589-0880
E-mail: info@fedfin.com Website: www.fedfin.com