COMPLEMENTARY OR COMPETITIVE?

THE ROLE OF PAYMENTS MARKET INFRASTRUCTURES AND CORRESPONDENT BANKS IN INSTANT INTERNATIONAL PAYMENTS

The growth in the number of markets in which businesses and consumers can make payments instantly has prompted an intriguing question: could instant payments be made across borders as well? This has added a new twist to the longstanding debate over whether links between domestic payments market infrastructures could replace correspondent banking networks. The exchange of views in the panel discussion at Sibos Toronto chaired by Lisa Lansdowne-Higgins, vice president, business deposit treasury solutions at RBC, proved the payments industry is still far from reaching a consensus on this issue.

"There is no doubt that correspondent banking has to evolve in order to survive," said Lisa Lansdowne-Higgins, vice president, business deposit treasury solutions at RBC, speaking at the session she moderated at Sibos in Toronto.[1] The audience was quick to agree. Polled at the outset of the session on whether the current correspondent banking model was ready to support a switch of all domestic and cross-border payments to a real-time model, the audience endorsed the view that payments market infrastructures (PMIs) were bound to assume a larger role, and that correspondent banking needed to change if it was to remain relevant.

Michael Bellacosa, director of global payments at BNY Mellon, countered that it was premature to write off the correspondent banks as the principal conduits of payments flows into and out of domestic markets. "Banks perform, at a very high cost, government surveillance, such as sanctions screening and anti-money laundering," he said. "We can put together infrastructures, but ultimately somebody has got to be responsible for how that works."

The future will not necessarily be bank-centric

Bellacosa pointed to the SWIFT Global Payments Innovation (gpi) as a good example of incremental change that leverages the correspondent banking networks already in place, allows banks to develop additional services on top of an infrastructural foundation, and reassures regulators by leaving the correspondent banks in place as the gateways into domestic PMIs. "I know gpi gets mocked for not going far enough," he commented. "But it is the first step in what could be an incredibly powerful system that remains bank-centric."

Andrew Brown, chief risk officer at Earthport, was not convinced that regulators favour a "bank-centric" outcome, arguing that they are actively using regulation to open payments markets up to non-bank competitors. "You may not want that, but it has been decided in certain places already, that you are going to have to accommodate that absence of exclusivity," he said. Brown predicted SWIFT gpi would be only one of a number of solutions that will developed for cross-border payments. "There will be different solutions to different requirements," he said, adding that his own organisation is already providing a service which "reflects more than the desires of the banks. It reflects something that regulators want, which governments want, and consumers want."

Standards are useful to capture network effects

Leila Fourie, the CEO of the Australian Payments Network, expressed concern about the possibility of multiple solutions emerging, on grounds that fragmentation of cross-border payments models would reduce the benefits of network effects. "There are more than 25 countries right now that have real-time payments," she said. "Internationally, this is becoming a fairly well-established, commoditised solution. But what we do not have is a contiguous, knitted-together, network effect between those countries. Making that leap is a profoundly important part of getting over those barriers in the next couple of years."

Her preferred outcome is a networked global marketplace, in which different participants contribute different components. "You may end up having an Amazon-type model, where the infrastructure and base marketplace is built by established players, and FinTech are building the overlay products and services on top of that," said Fourie.

Michael Steinbach, the CEO of equensWorldline, argued that a network of this kind would prove impossible unless both bank and non-bank payments service providers converged on the use of the ISO 20222 messaging standard. "One of the biggest barriers is to connect to the local network," he said. "In our experience, this is always a big effort."

Michael Bellacosa agreed standardisation is important but cautioned that messaging standards have a habit of developing national variants. "What we have seen over time, especially with agreements on the type of information [to include in a message], [is that] even under a standard, you do not have a standard," he said. "There are different interpretations of how to use data."

National regulatory barriers remain an obstacle to efficient cross-border payments

One issue on which all panellists could agree is that differing national regulatory regimes remain a persistent obstacle to instant payments across borders. Each jurisdiction applies different laws, regulations and reporting requirements to its domestic payments industry. Michael Steinbach noted that, even on the cusp of the introduction of instant payments in euro, regulatory barriers continue to exist between the various countries that make up the single euro payments area (SEPA).

"There is no single regulatory environment at a global level," agreed Andrew Brown. "We are not going to see in our lifetime a single narrative for legislation that encompasses all the countries of the world at legislative, regulatory, data management and privacy levels."

Michael Bellacosa agreed that the payments industry would have to wait a long time before government regulations were harmonised. That lack of harmonisation put a premium on technology capable of facilitating inter-operability between correspondent banks accessing PMIs in different countries. "Their technology to you has to be efficient and effective, and your technology to them also has to be efficient and effective," he said.

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- Andrew Brown, Compliance and Regulatory, Earthport

Technology not an alternative to clearing regulatory barriers

Andrew Brown thought this was challenging to achieve on a global scale. "[Banks] are bought-in to [their] systems for a long time," he said. "That means the slight changes there might be in interpretations of requirements can be really difficult to meet at every border when you are doing transactions across multiple jurisdictions."

Michael Steinbach argued the technology investment necessary to clear national regulatory barriers, and different technical standards, is beyond all but a handful of genuinely global banks. He nevertheless thought they would make the investment, prompting revolutionary changes. "There are tremendous investments in front of the industry to build a real-time infrastructure," he said. "In doing that, we are talking not only about payments. It is about the whole IT infrastructure, because it is end-to-end."

Commoditisation, consolidation and customers will force banks to innovate

Steinbach maintained that only a small number of global banks have sufficient size and scale to survive, predicting 1,000-bank correspondent networks will consolidate into no more than 80 to 100 institutions. "Within a foreseeable time-frame, no bank will make any money out of a nice payments app," said Steinbach. "There will be a complete change in business models."

Leila Fourie concurred that real-time payments across borders will be commoditised, under pressure from consumers. "Customers do not just want it now – they want it all," she said. "So real-time payments are not sufficient to sustain us. We have to have real-time, end-to-end customer solutions."

She described the New Payments Platform (NPP) in Australia as "an underlying set of rails" which enable banks to develop those solutions. The NPP also creates opportunities, she added, for partnerships between banks and non-banks, including FinTechs. She expects banks to use Big Data sifting, artificial intelligence (AI) and machine learning to personalise payments services, as well as delivering payments in real-time.

Andrew Brown cautioned that not every individual customer wants everything, now. "They want what they want, right now," he said. In markets where real-time payment services did not yet exist, he detected no clamour for them. As he also pointed out, not all payments are urgent. "It will not be real-time for everything," he said. "There will be different costs from providers that can provide enough volume in one area, but not in another. I think that

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Complementary or competitive? The role of payments market infrastructures and correspondent banks in instant international payments
took place at Sibos Toronto on Tuesday 17 October 2017

View the entire panel discussion **here**.

Moderator

Lisa Lansdowne-Higgins
Vice president, business deposit treasury solutions at RBC

Panellists

Andrew Brown
Compliance and regulatory, Earthport

Michael Bellacosa
Director of global payments, BNY Mellon

Leila Fourie
CEO, Australian Payments

Michael Steinbach
CEO, equensWorldline

is a good thing. It breaks up some of the monoliths that have exerted an inertia."

Are correspondent bankers part of the change or an obstacle to change?

In fact, Brown thought this inertia the principal obstacle to change in cross-border payments. "Correspondent banking is an old model," he said. "It has served a lot of businesses and individuals very well for payments internationally for a long time, but it has a lot of flaws. There is a very good argument that it is beyond its lifespan. But changing people who are in a global industry that has been very successful, and built on that for decades, getting them to move away from the idea that that is the solution that has to be tweaked to meet the next challenge, and getting them to acknowledge that, `No, maybe, actually, that is no longer the solution, period' - that is very, very difficult." He argued that, given persistent legislative and regulatory differences, linkages between domestic payments clearing systems made sense.

Michael Bellacosa disagreed, reiterating his view that correspondent banks must remain central to any effective response to the challenge of instant payment across borders. "Who is going to make the change?" he asked. "Because, ultimately, there is a cost. Those horrible banks have paid for these infrastructures, and paid a ton of money to develop the internal, domestic infrastructures, which, fundamentally, they do not get paid for – as a starting point."

In his view, correspondent banks make up for that investment in domestic PMIs by charging more for cross-border payments, and will therefore be unwilling to invest in cross-border links between PMIs. "It is not being head-stuck-in-the-sand, or the fact that [the banks] do not want change, or do not want to improve [the system of cross-border payments]," he said. "It is just an economic reality. The right change [is the one] that creates the right incentives and the right models to improve it. If you are paying for the solution, it better have a benefit for you. Connecting cross-border and connecting domestic payments systems to each other is not the only way to accomplish what needs to be accomplished. From a banking perspective, you want to keep it bank-centric." Bellacosa thought a public utility was one model that might work, but he insisted banks should not be expected to fund developments from which they derive no benefit.

Andrew Brown agreed there was "some legitimacy" in this point of view, but countered that payments markets are highly regulated, so banks enjoy a privilege in serving them. "It is a bit disingenuous to talk about the people who pay for it as if it is the banks because it is the customers that pay for it," he said. "The customers in a domestic environment are not ever going to be able to pay for a service in a settlement country when they send a payment other than by being a reciprocal part of the payment being made. In that sense it is a shared environment already. It – correspondent banking – has always been a shared environment, in terms of the payer and the user."

A consensus that blockchain is not the remedy for cross-border payments

One final challenge on which the panel was unanimous is blockchain. All four members were sceptical about claims that distributed ledger technology (DLT) would revolutionise the industry in the near-time. Michael Bellacosa thought widespread adoption hinged on the issue of fiat currencies on to a blockchain. Leila Fourie noted that every bank had identified use-cases, and was pilot-testing the technology, but described it as nascent, immature and difficult to scale. She thought digital identification and authentication was the most promising area in which to make use of the technology.

Andrew Brown advanced trade finance as the most obvious use-case. He added that Earthport is working with Banco Santander on a distributed ledger service that is actually in live production, but even he agreed the technology was not yet capable of general application. "Incremental improvement is what we will see," he said. "I do not think somebody like me will, in the rest of my career, find himself usurped by a lack of knowledge about blockchain and DLT. I think there is a place for a lot of us for a long time before that takes over the world."

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