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TO:
Committee on Payments and Market Infrastructures
Via email: cpmi-conference@bis.org

February 8, 2021

Re: Pushing the frontiers of payments: towards a global payments area – Call for Industry Expert Responses

Dear Sirs,

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) welcomes the opportunity to comment on behalf of its members on the *Pushing the frontiers of payments: towards a global payments area – Call for Industry Expert Responses* request by the Committee on Payments and Market Infrastructures (CPMI) on December 23, 2020.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 24 global foreign exchange (FX) market participants,[1] collectively representing a significant portion of the foreign exchange inter-dealer market. Both the GFXD and its members are committed to ensuring a robust, open, and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

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Theme 1: Making existing payment infrastructures and arrangements fit for cross-border purpose

1. **What targets seem to be reasonable when it comes to enhancing cross-border payments and how can geographic and use-case specific differences be addressed? How can it be**

1 Bank of America, Bank of New York Mellon, Barclays, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Mizuho, Morgan Stanley, MUFG Bank, NatWest Markets, Nomura, Northern Trust, RBC, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

ensured that the targets are realistic, while at the same time ambitious? How can progress be monitored and assessed?

GFXD Response

To define what could be enhanced, it is necessary to determine what is of importance and why. For cross-border wholesale FX gross (deliverable) payments, the management of Principal Risk is key.

Principal Risk is defined in the 2013 BCBS 'Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions' (BCBS Supervisory Guidance) as:

'The risk of outright loss of the full value of a transaction resulting from the counterparty's failure to settle. This can arise from paying away the currency being sold, but failing to receive the currency being bought. (Also referred to as "Herstatt Risk").'

There are several considerations when assessing the efficacy of the settlement of wholesale FX transactions and Principal Risk. Examples include:

1. How to measure Principal Risk and how is the risk mitigated (e.g. through increased use of payment versus payment (PvP) mechanisms)?
2. What is the period through which the settlement occurs and how can it be minimised?
3. When can Settlement Finality [2] be determined?
4. What are the costs associated with the settlement process?

The guidelines in the BCBS Supervisory Guidance tend to cover examples 1, 2, and 3 above. Costs tend to be determined by commercial arrangements.

Where a nostro agent is involved in the settlement, the ability of their customer in assessing their performance against these four (and any other considerations) is largely dependent on the actual services provided by the nostro agent. These services will depend on either: i) the services which a nostro agent can provide, or ii) commercial arrangements between the nostro agent and its customer.

A target, given that the goal of this CPMI exercise is to provide a more efficient settlement process for cross-border payments, is to implement a consistent minimum set of standards for nostro agents or any new service providers. The industry can be consulted to ensure that the standards include the most realistic and beneficial outcomes. For example, in order for a customer to be able to know that Settlement Finality has been determined as soon as possible, a nostro/service provider could improve the timeliness of account reconciliations and adopt the regular use of electronic communications.

Such minimum standards, especially when looking to implement increased PvP solutions, could allow firms to better assess the timeliness of achieving Settlement Finality and managing any associated risks. Minimum standards could be implemented across jurisdictions and be easily monitored and assessed.

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2 https://www.bis.org/publ/bcbs241.pdf The irrevocable and unconditional transfer of an asset or financial instrument, or the discharge of an obligation by the FMI or its participants in accordance with the terms of the underlying contract. Final settlement is a legally defined moment.

This can be expected to promote a level playing field between established and new service providers, resulting in additional competition and innovation, ultimately leading to a better and more cost-effective service.

2. **What should central banks consider when expanding access to central bank money settlement to non-banks?**

<u>GFXD Response</u>

We believe there are two main areas to consider when expanding the access to central bank money settlement to non-banks and we believe there is a role for central banks in providing guidance to address the high barriers of entry for any new market participants. The two areas to consider are:

Governance:

Different considerations come into play when introducing any new participant (including new technology or infrastructure) into an existing ecosystem, and whilst there are already many papers and reports discussing these, we thought that there would be value in highlighting the following governance items for consideration by central banks.

- What governance standards (including digital inclusion/access and if appropriate limiting the amount of (retail) central bank digital currency (CBDC) available) should apply to the central bank network and ecosystem, what roles should each participant play and what are the responsibilities/liabilities attached to those roles, including for theft, loss and fraud;
- What regulations will apply to new participants licensed to handle settlement, so that those entities do not introduce undue risk to the system. Where possible, the central bank should leverage existing rules and ensure a consistent approach across the relevant ecosystem (s) to create a level playing field and provide regulatory clarity; and
- How will such participants operate and be regulated in conjunction with other jurisdictions' central bank systems, including future considerations such as CBDCs or other new private forms of digital money such as stablecoins [3].

Market Operation:

We believe that there should be an effort to ensure the ongoing safe and trusted operation of the wholesale financial markets and note that new risks may arise due to the potential introduction of new participants.

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3 Stablecoins are defined here as tokens designed to minimize/eliminate price fluctuations relative or in reference to other asset(s) which are not issued by a central bank, FMI, bank, credit institution or highly- regulated depository institution. May represent a claim on the issuing entity, if any, and/or the underlying assets. For more detail please see Annex A of the GFMA response to the BCBS Discussion Paper on Designing a Prudential Treatment for Crypto-assets - https://www.gfma.org/wp-content/uploads/2020/04/gfma-bcbs-prudential-crypto-assets-final-consolidated-version-20200427.pdf

To mitigate these risks and to provide clarity to the market, so the risks and implications can be assessed, the central bank may wish to consider:

- Whether the application of industry standards, such as those documented in the Committee on Payments and Market Infrastructures-International Organisation of Securities Commissions (CPMI-IOSCO) 'Principals for Financial Market Infrastructures' [4] (a set of international standards for financial market infrastructures (payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories)) should extend to any new participants; and,
- Whether the inclusion of new providers would introduce elements of opacity, added complexity or disruption, in respect of known network risks in the existing ecosystem. The network risks existing within today's wholesale financial markets are complex but well understood and accounted for, so any added complexity should be weighed against the potential benefits of introducing new participants.

We also believe consideration should be given to the more practical implications of expansion of access to central bank money on established operational processes, to ensure that wider disruption does not occur, and that additional undue risk is not added into the ecosystem.

Such implications could result in the requirement for additional controls and/or resources for both the public and private sectors, especially if such changes result in changes to the operation of the market, such as offshore providers being used rather than local correspondent banks.

3. **How can operating hours be expanded for the benefit of cross-border payments, even if 24/7 operation cannot be achieved in the near term? What might be the risks and costs associated with it?**

GFXD Response

We discuss extended RTGS operating hours in our 2020 paper titled 'First Steps Towards 24/7 FX Settlement Capabilities Expanding Payment versus Payment (PvP) opportunities' [5].

The key consideration for us in our paper was that an extension of central bank operating hours is a means to create the opportunity for more PvP settlement of cross-border wholesale deliverable FX transactions. More PvP settlement will result in a reduction of Principal Risk. However, whilst greater overlap of central bank operating hours is welcomed, there still needs to be a mechanism/tool to facilitate the simultaneous settlement on a PvP basis, with legal finality, of the two currencies being exchanged pursuant to the cross-border wholesale FX transaction.

Faster payment systems tend to be more suitable for low-value retail settlements due to the general limitations on the amount of currency that can be settled and, would still require the use of a suitable

4 https://www.bis.org/cpmi/info_pfmi.htm

5 https://www.gfma.org/wp-content/uploads/2020/03/expanding-pvp-opportunities-march-2020.pdf

mechanism/tool to facilitate simultaneous settlement of the two currencies on a PvP basis.

Given that the wholesale FX market is global in nature and operates across borders and time-zones, it may be necessary to reconsider the concept of Settlement Date (Value Date) for certain transactions, potentially even aligning with the concept of a 'global trading date' which is used in trading.

Currently the Settlement Date is applied to the local business day of each currency within the transaction and is therefore especially relevant when considering increased opportunities for PvP settlement, particularly when the Central Bank RTGS systems of the two currencies involved in the transaction may not overlap.

For example, considering a transaction in AUDUSD settling on 1 March, the AUD will settle on the 1 March in Australia, whilst the USD will settle on 1 March in the United States, which due to the time-zone differences will actually be the next business day (i.e. 2 March) in Australia.

We note too that the challenges created through mismatches in RTGS operating hours was specifically discussed in the November 2018 paper [6] published by the Bank of Canada, Bank of England and Monetary Authority of Singapore and we recommend this paper in any deliberations.

Finally, we identified a series of questions which we believe will help to further this discussion. These are:

Market-wide Considerations:

- If RTGS operating hours were extended, would the specific RTGS membership policies and procedures require amendments to ensure a steady flow of liquidity throughout the day?

- Are there considerable benefits of scale should multiple Central Banks look to extend their RTGS operating hours?

- Are market participants able to quantify the potential benefits across the whole value-chain (e.g. credit and capital benefits) against the changes which would be required to accommodate such changes (e.g. staffing models)?

- Given the incentives to settle on a PvP basis (e.g. credit/liquidity management), and the potential benefits of wider participation, would market participants look to settle all non-PvP transactions on a PvP basis or a sub-set of transactions and what is the impact of this?

- How can market participants ensure that nostro providers can take advantage of extended RTGS operating hours?

6 https://www.bankofengland.co.uk/news/2018/november/boe-boc-mas-joint-report-digital-transformation-in-cross-border-payments

Funding:

- FX as an asset class is often used to fund the purchase or sale of other assets, with the FX transaction normally settling on the same day as the asset. How would the market migrate to facilitate simultaneous settlement of the FX transaction and the underlying asset?

- Are the new solutions which are moving the industry towards 24/7 settlement interoperable, both within FX and cross-asset?

- Are new funding markets created, or are there considerations for existing funding markets, such as the operation of the repo market?

Operating Practices:

- Extended settlement windows would likely result in lengthened trading days. Could existing regulatory requirements be accommodated (e.g. same day post-trade reporting), were trading to be extended to later in the day?

- If trading were to continue later in the day, would both counterparties to the transaction have staff available to resolve any issues on trade date, for example ensuring confirmation timeliness?

- Are there additional impacts to other processes e.g.
    - Margin/collateral practices: for instance, would it be possible to post margin on the same day as the margin call has been calculated?
    - Capital: for instance, how could the capital allocated for Principal Risk be optimised?
    - Liquidity: for instance, are liquidity profiles expected to change as RTGS operating hours extend, and will operational and business tools may be expected to change too?

4. **What role can interlinking play for improved cross-border payments and how can it be achieved? What are existing operational, technical, legal and/or commercial barriers and what are possible downsides?**

GFXD Response

Direct interlinking between central banks for currency settlement purposes already exists, for instance as seen between Hong Kong and Thailand, Malaysia and Indonesia [7].

We believe that there are benefits to such arrangements, especially when used by the market at scale, noting that there will be even greater benefits should more than two central banks engage.

7 https://www.hkma.gov.hk/eng/news-and-media/press-releases/2014/07/20140728-3/

For example, greater efficiencies could be expected with a larger 'RTGS of RTGS' system in which multiple central banks are directly connected. We expect that this could facilitate multilateral netting of settlements and then simultaneous settlement of any subsequent cash flows, enabling an even greater quantity of cross-border payments to settle on a PvP basis.

Whilst this model initially seems very similar to that operated by CLS Bank International (CLS), there will be additional challenges to overcome, such as governance and oversight. This will require significant coordination and collaboration between central banks, not least to ensure that their operating hours do not limit opportunities. Whilst CLS are well established in their operations, there remains a population of trades which settle outside of CLS. To address these trades, it may be that there is an opportunity for either an existing or new infrastructure provider to connect central banks.

It is also worth considering the provision of liquidity, as this normally incurs a cost. Multiple settlement channels/processes, with multiple settlement cut-off times will usually result in complex and well-orchestrated liquidity requirements [8] i.e. ensuring funds are present at different times during the day in order to meet multiple payment obligations. Efficiencies result from the ability to net any payment obligations (i.e. reduce the size of the obligation) and to be able to predict and manage when funds will be present on an account for use.

Similarly, the considerations raised above in Question 3 (Market-wide, Funding and Operating Practices) will apply in the context of this question, especially as it can be expected that central banks will maintain the ability to also operate their traditional RTGS systems and therefore maintain independent settlement functionality too.

5. **What aspects need to be considered if central banks were to offer reciprocal liquidity bridges in multiple LVPSs?**

<u>GFXD Response</u>

The concept of reciprocal liquidity bridges in large value payment systems is not one that is immediately familiar to our members, and a suggestion was made that the industry could benefit from more communication as to the processes and mechanisms of such systems.

We expect that such systems could be used to create access to funding in currencies that are typically active when other currencies are not, but this itself raises several questions for consideration, such as:

- How would such systems interact with other sources of funding, including the ability to sequence/time payments?
- How will central banks increase the attractiveness of such systems versus other funding mechanisms?
- How will overdrafts be offered, funded and managed to avoid any potential fail to pay scenarios?
- How will fail to fail to pay scenarios be managed?

8 https://www.bis.org/publ/qtrpdf/r_qt0212f.pdf

6. **How can the availability of PvP to a wider range of transactions and actors be expanded? What is the associated potential to remove risks, and thereby ultimately lower costs?**

GFXD Response

Trades settling outside CLS or another PvP system tend to fall within two categories, either:

- The trade was eligible and for some reason was settled outside of the PvP system, or
- The trade was not eligible for settlement in the PvP system.

Given the wholesale FX industry's desire to reduce Principal Risk and settle as many trades as possible on a PvP basis, the one focus should be on understanding which trades are not eligible - but which create Principal Risk - and what can be done to mitigate that Principal Risk absent eligibility for PvP.

Analysis can then be performed on what existing or new central bank approved PvP systems, or new technologies facilitating PvP settlement, could be suitable in addressing that population of trades. If multiple new solutions are used by market participants, then interoperability between these solutions is preferable to optimize the benefits.

For example, it would be useful to understand what mechanisms are available to maximise liquidity on a multilateral basis between PvP settlement systems/obligations. This should give market participants the ability to better manage their liquidity obligations, costs and risks.

There will be a timing and technological element to this, hence the importance of the previous question on RTGS operating hours – the technical element referring to the ability to quickly identify and deploy liquidity (or high-quality liquid assets) to meet settlement obligations.

Theme 2: Streamlining data exchange to improve cross-border payments

7. **What are the main challenges in agreeing on and implementing common message formats and API protocols for cross-border payments and how can we overcome them?**

GFXD Response

The FX market is the world's largest financial market, and the effective and efficient exchange of currencies underpins the international financial system. The FX market is also the basis of the global payments system, meaning the volume of transactions is very high, with transactions often executed by market participants across geographical borders.

Sovereign entities, central banks and other government sponsored entities rely on the FX market to be well-functioning and liquid, and corporations and investors regularly participate in the market for important operational needs:

- To reduce risk by hedging currency exposures;
- To pay suppliers and to be paid for services outside their home market;

- To convert their returns from international investments into domestic currencies; and
- To make cross-border investments and raise funding outside home markets.

The key to any success will be greater coordination, interoperability and consistency in approach across the high numbers of users participating in both the FX market direct, as well as those active in other markets but using wholesale FX to fund their operational needs.

Wholesale capital markets have many examples of coordinating on such scale and there are experiences to leverage.

Following the 2009 G20 Pittsburgh Summit, the G20 agreed to implement a series of objectives, one of which was to improve the transparency of the over-the-counter derivatives markets, primarily via the implementation of trade reporting to supervisors.

Since then, there have been multiple roll outs of regional trade reporting requirements, most of which were regional specific and lacked global harmonisation.

Recognising this, the FSB in 2014 [9] conducted a study on approaches to aggregate OTC derivatives data, ultimately resulting in the definition of a series of common data elements. Regulators are now in the process of consulting on and implementing such common data elements at the local level.

We recommend that the CPMI team leverage the experiences of their supervisor colleagues to discuss some of the challenges in agreeing and implementing common formats and standards across multiple jurisdictions and recommend the following:

- The industry is consulted to identify what data points are of benefit including what they will be used for;
- Consideration is made to local language and customs;
- Data standards, user guides and supervisory expectations are explicit and do not leave room for any interpretation;
- Data standards are relevant to the products and processes rather than trying to fit to suit; and
- The importance of the network effect and pace of adoption.

8. **What are the main technical, operational, legal and business implications of standardisation in cross-border payments (or a lack thereof)?**

GFXD Response

The GFXD is not responding to this question.

9. **How can the use of agreed frameworks with a built-in enforcement mechanism based on both automated rules and institutional and contractual arrangements be agreed upon?**

9 https://www.fsb.org/2014/09/r_140919/

What lessons can be learned from international card schemes and initiatives such as SWIFT gpi?

GFXD Response

The GFXD is not responding to this question.

10. **Where do conflicts between data frameworks and cross-border payments emerge and how can they be addressed?**

GFXD Response

The GFXD is not responding to this question.

Theme 3: Exploring the international dimension of new payment infrastructures and arrangements:

11. **What are the relevant technical, legal/regulatory and/or business considerations when it comes to the design and implementation of these new payment infrastructures and arrangements to make them a suitable option for cross-border payments? What are the main operational considerations to shorten transaction chains and achieve a transparent payments process?**

GFXD Response

Previously in our response we discuss the role of Settlement Finality in managing Principal Risk. Any new technologies need to ensure that funds settle with legal finality.

We further develop our thoughts about the impacts of new technologies on cross-border settlements in our 2020 paper titled 'First Steps Towards 24/7 FX Settlement Capabilities Expanding Payment versus Payment (PvP) opportunities'[10], concluding that the impacts of extended RTGS operating hours would likely be the same as the impacts seen with the use of stablecoins and/or CBDC.

Assuming that the new payment model will result in PvP settlement across an extended settlement window, (ultimately leading to real-time, 24/7 PvP settlement) we initially focused on identifying and discussing business, legal and technical considerations, which we grouped as: i) internal dependencies (e.g. process and technology abilities, location strategy and staffing model) and, ii) external dependencies (e.g. network effect, migration strategy and settlement date convention).

To understand the impacts of these on operational processes, we performed a deeper dive concluding that all would likely be impacted through the introduction of new settlement technologies.

10 https://www.gfma.org/wp-content/uploads/2020/03/expanding-pvp-opportunities-march-2020.pdf

Table 1: Generic FX post trade processes

When	What	Impacted by RTGS extension?
Value Date (VD)	Non- PvP transaction matching and confirmations	Likely
VD	Non- PvP net and gross settlements	Likely
VD	Intra-day controls and reconciliations	Likely
VD	Intra-day liquidity management	Likely
VD	Final checks prior to cut-off	Likely
VD/VD + 1	Regulatory reporting	Likely
VD	EOD batch processes: ledgers and statements	Likely
VD+1	Nostro reconciliations/EOD statements	Likely
VD+1	Use of funds	Likely

Our view was that these processes are time dependent and would therefore be impacted by any new technologies which could extend the settlement cycle, such as extended RTGS operating hours, stablecoins or CBDCs.

As regards stablecoins and multilateral platforms:

a. **What aspects need to be considered to deal with a plurality of legal systems and regulations? What needs to be taken into account to foster competition and efficiency, without compromising on safety, compliance, reliability and resilience?**

b. **To what extent do new payment infrastructures and arrangements rely on interoperability with existing payment infrastructures and how can interoperability be achieved?**

GFXD Response

In our 2019 paper titled 'Considerations relevant to initiatives and developments in wholesale FX settlements'[11] we introduce and discuss three main areas which we believe will be impacted by the introduction of new settlement technologies. These are:

1. Settlement risk (also known as Principal Risk);
2. Liquidity risk (the ability to fund obligations when due);
3. Disruption risk (the impact of a new technology/model failure on the whole ecosystem).

As we note under the disruption risk section,

'The expectations, roles and responsibilities of market participants currently involved in the wholesale FX market is well understood, for example as documented in the CPMI-IOSCO 'Principals for Financial Market Infrastructures',[12] *a*

11 https://www.gfma.org/wp-content/uploads/2019/09/developments-in-wholesale-fx-settlements-september-2019.pdf

12 https://www.bis.org/cpmi/info_pfmi.htm

set of international standards for financial market infrastructures (payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories). Market participants are therefore able to assess and manage their multiple risk exposures accordingly and the transparency afforded through the knowledge that those they interact with comply with industry established Principals is of considerable value in promoting the safe operation of the market, including the settlement of wholesale FX.

As changes to today's wholesale FX settlement processes are contemplated, or introduced into the FX market – whether from new technologies or through the evolution of existing technologies e.g. those used in other sectors, such as retail - it is important to ensure that the expected high standards of operation continue, so that participants can successfully assess the risks they are exposed to. Whilst not limited to, some of these parameters could include assessments of exposure to market participants, specific currencies or even the volumes of trades executed.

In the event of a failure, a new risk of contagion could be introduced if the importance of, or known networked exposure to, the technology within the ecosystem was not widely understood.'

We believe that these three areas (settlement, liquidity, disruption risk) remain important today and should form the basis of any legal and regulatory analysis into the introduction of new settlement technologies.

In our 2018 paper titled 'GFXD recommendations for the promotion of interoperability between new technologies and service providers'[13] we identify a series of statements which we believe are fundamental when considering any new technologies within the cross-border wholesale FX market.

These are:

- We believe that there will be multiple ledger-based protocols which will need to be considered as part of a smart contract interoperable framework;
- We believe that there will be unique as well as shared use cases and solutions across firms, solution providers and market infrastructures;
- We believe that consideration will be required for both asset class and regulatory variances;
- Data security and encryption are of the utmost importance;
- Market fragmentation can be minimised if interoperability is achieved; and,
- The record on the ledger must be immutable.

Interoperability is key is achieving success and efficiencies at scale across the ecosystem – to help promote interoperability and therefore increase the likelihood of delivering on the benefits of new technologies, we proposed a series of interoperability parameters which we believe should be the minimum to enable a continued operation of the ecosystem.

These are:

- Governance of services and provision of consensus/trust;
- Smart Contracts facilitating business processes;

13 https://www.gfma.org/wp-content/uploads/2018/09/recommendations-for-the-promotion-of-interoperability-between-new-technologies.pdf

- Data control including;
- Data elements;
- Trusted data sources;
- Data security;
- Encryption;
- Message types and formats;
- Linkage of data across internal and/or external ledgers;
- Networks; and,
- Business models.

As regards CBDCs:

c. What do central banks need to do in order to obtain buy-in from the private sector and ensure widespread adoption?

GFXD Response

In our recent position paper to the European Central Bank titled 'Considerations for a retail Digital Euro'[14] we introduce a series of overriding themes which we believe should be upheld in the proposal or design of a CBDC, irrespective of whether the CBDC is intended for use in the retail or wholesale markets. We believe that these themes will help promote the adoption of a CBDC for cross-border wholesale FX payments.

To protect end users and wider financial stability, whilst driving greater efficiencies, we recommended that central banks/a CBDC should:

- Be interoperable with existing market infrastructures and processes, including between a CBDC and its fiat cash equivalent;
- Identify and mitigate any new or additional risks to the global financial system;
- Not create undue disruption to existing wholesale financial markets, including the provision of liquidity and settlement;
- Provide benefits when compared to using physical cash/electronic transfers; and
- Promote innovation for new services and propositions following implementation.

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14 https://www.gfma.org/wp-content/uploads/2021/01/2021-01-12-afme_gfxd-ecb-retail-digital-euro-1.pdf

We appreciate the opportunity to share our views and look forward to our continued engagement with the CPMI on this important topic.

Please do not hesitate to contact Andrew Harvey on +44 203 828 2694, email aharvey@gfma.org should you have questions about our comments or wish to discuss any of the above.

Yours faithfully,

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