# GFMA Global FX Division

## GFXD recommendations to reduce FX payment errors and associated risks

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## Background to the Global Foreign Exchange Division

The Global Financial Markets Associations (GFMAs) Global Foreign Exchange Division (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 25 global foreign exchange (FX) market participants[1], collectively representing the majority of the FX inter-dealer market[2]. 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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[1] Bank of America, Bank of New York Mellon, Barclays, BBVA, BNP Paribas, Citi, Credit Agricole, Deutsche Bank, Goldman Sachs, HSBC, ING, JP Morgan, Lloyds, Mizuho, Morgan Stanley, MUFG, NatWest Markets, Nomura, Northern Trust, RBC, Standard Chartered Bank, State Street, UBS, US Bank and Wells Fargo

[2] According to Euromoney league tables

## Introduction

In this second[3] paper on managing risks related to the settlement of FX transactions, the GFXD Operations Committee[4] is keen to explore how the industry can better manage those instances when a FX payment is made in error.

Fortunately, the proportion of payment errors within the wholesale FX markets remains small, especially when considering the total volume of FX transactions settled on a daily basis. However, as the FX market is typified by transactions with sizeable notionals, payments made in error tend to attract significant internal - and external - focus.

The Global FX Committee (GFXC), through updates to the Global Code[5] is actively promoting settlement methods to reduce FX Settlement Risk.

Pr35 in the Global Code states that:

> 'When determining settlement methods for FX transactions Market Participants should consider the following hierarchy to reduce Settlement Risk:
>
> 1. Where practicable, Market Participants should eliminate Settlement Risk, for example by using settlement services that provide PVP settlement.
>
> 2. Where Settlement Risk cannot be eliminated, Market Participants should reduce the size and duration of their Settlement Risk as much as practicable. The netting of FX settlement obligations (in particular the use of automated settlement netting systems) is encouraged.
>
> 3. Where practicable, gross bilateral settlement should be minimised.'

Whilst payment versus payment (PVP) can also mitigate the risk of payments being made in error, other settlement methods (e.g. netting, gross bilateral) are still at risk of payment error e.g. a gross, bilateral settlement amount paid to an incorrect settlement instruction.

It is this fact that motivated the GFXD Operations Committee to perform this analysis, and in doing so to provide a series of points for market participants to consider in the evaluation of their wholesale FX settlement processes.

Finally, the GFXD Operations Committee also believes that the processes around the management of the return of any funds paid in error is also suitable for further consideration in this paper. Analysis has shown that there are varying different approaches taken across the market, which tend to lead to unwanted delays and increased risk and cost.

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[3] https://www.gfma.org/wp-content/uploads/2022/05/reducing-settlement-risk-may-2022-1.pdf
[4] The GFXD Operations Committee comprises senior FX operations professionals from GFXD member banks
[5] https://www.globalfxc.org/uploads/fx_global.pdf

## Executive Summary

- **The proportion of payment errors within the wholesale FX markets remains small.**
- **Banks have developed well established processes to monitor and control payment errors.**

**Recommendations to reduce payment errors**

1. **Market participants involved in the full F2B FX lifecycle are educated on the common causes of FX payment error, including:**
    - **Execution – late or incorrect allocations, trade or payment shaping, booking errors (including bookings after currency-cut-offs), cancel & rebooks.**
    - **Incorrect settlement instructions (incorrect format, incorrect choice).**
    - **Netting (ad-hoc change from net/gross, or manual processes).**
2. **Market participants leverage the 2013 BIS Supervisory Guidance to Managing FX Settlement Risk and the Principals in the Global Code when designing and implementing procedures.**

**Recommendations to ensure funds paid in error are returned as quickly as possible**

1. **Payment recall and kickback processes should be prioritised and take no longer than 5 business days.**
2. **Funds received in error should be returned as soon as possible.**
3. **Remitter of the funds should issue a recall notice as soon as they realise funds have been paid in error; the beneficiary should acknowledge the notice**
4. **Automated and authenticated communication methods (e.g. SWIFT, ISO20022) should be leveraged.**
5. **Any jurisdictional differences for the recall-kick back process should be aligned.**

## Payment Errors

A payment error – deemed in this paper to be one where there is the potential for non-recovery of funds paid in error - can be caused by many factors. Typically these are due to an error related to one/more of the attributes of a wholesale FX transaction, such as direction, counterparty, currency/notional and settlement date. It is for these reasons that the confirmation process is performed as close as possible to when the transaction is booked, ensuring that the details booked are equal to those executed and known by the other participant.

It is this risk of non-recovery of funds that tends to result in payment errors receiving very high attention as part of control frameworks. Typically, internal escalation thresholds tend to be comparatively lower for payment errors versus those for other settlement issues (e.g. late receipt of funds) and often include deadlines, such as funds to be returned within 5 business days.

In researching this paper, the GFXD Operations Committee identified the following as the main causes of FX payment errors:

- Execution – late or incorrect allocations, trade or payment shaping, booking errors (including bookings after currency-cut-offs), cancel & rebooks.

- Incorrect settlement instructions (incorrect format, incorrect choice).
- Netting (ad-hoc change from net/gross, or manual processes).
- Rescinds from PvP settlement mechanisms (e.g. CLS).
- Payment formatting (systemic or human error).
- Funds paid to the wrong entity within the same organisational structure (often it is not possible to internally move funds).

In consideration of: i) these multiple causes of payment errors, ii) the sheer volumes of FX transactions executed on a daily basis and iii) the generally large notional of a FX transaction, it is critical that those engaged in the execution and settlement of FX transactions understand the front to back processes/mechanics/timings as well as how automation and standardisation are key factors in mitigating payment errors, and thus reducing FX Settlement Risk.

There are many sources of information available for market participants when considering their practices.

In the 2022 GFXD paper titled 'GFXD recommendations for Reducing Settlement Risk'[6], we made 14 individual Recommendations for non-PVP settled FX transactions, summarising that market participants:

- Adopt the Global Code.
- Increase the use of automated processes.
- Increase education on currency cut-offs and specific procedures across the full trade lifecycle.
- Increase the use of standardised processes and settlement methods including instructions and netting preferences.

The Global Code also has several Principals which can support the reduction in payment errors:

> Pr32: 'Market Participants should have appropriate processes in place to identify and manage operational risks that may arise from human error, inadequate or failed systems or processes, or external events. Operational risks could include those arising from human error, misconduct, systems issues, or unforeseen external circumstances.'

> Pr35: 'Market Participants should agree which settlement method will be used for a given product and currency as part of the counterparty onboarding process. Once agreed, the settlement method should be used consistently, and ad-hoc arrangements with the same counterparty considered only on an exception basis.'

> Pr51: 'Market Participants should use Standard Settlement Instructions (SSIs). SSIs should be in place, where practicable, for all relevant products and currencies for counterparties with whom a Market Participant has a trading relationship. Because of the Settlement Risks it introduces, the use of multiple settlement instructions with the same counterparty for a given product and currency should have appropriate controls. Where multiple settlement instructions are used, there should be a default SSI that applies until otherwise advised.'

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6 https://www.gfma.org/wp-content/uploads/2022/05/reducing-settlement-risk-may-2022-1.pdf

Pr53: 'Market Participants should have adequate systems in place to allow them to project, monitor, and manage their intraday and end-of-day funding requirements to reduce potential complications during the settlement process. Market Participants should send payment instructions as soon as practicable, taking into consideration time zone differences as well as instruction receipt cut-off times imposed by their correspondents. Market Participants should communicate expected receipts (via standardised message types, when possible) to allow nostro banks to identify and correct payment errors on a timely basis and aid in the formulation of escalation procedures.'

Finally, in order to reduce the numbers of payment errors, it is important for market participants to employ a suitable oversight framework. For example, Section 1 'Governance' of the 2013 BCBS supervisory guidance for managing risks associated with the settlement of foreign exchange transactions[7] states that:

'A bank should have a comprehensive risk management framework to manage FX settlement-related risks commensurate with the size, nature, complexity and risk profile of its FX activities. This framework should cover all material risks including principal risk, replacement cost risk, liquidity risk, operational risk and legal risk. The framework should include policies and procedures, limit structures, management information systems and key risk indicators, fails management, escalation procedures and an internal audit and compliance program.'

## Late Receipt of Funds

Other factors which influence the payment process itself, such as deviations from established settlement processes (e.g. changes to settlement instructions, ad-hoc changes from settlement netting to gross settlement) can also increase operational risk and therefore the risk of receiving funds late – and again considerations to address are well documented such as in the Global Code[8] .

Whilst the industry has long-established processes to accommodate the late receipt of funds (e.g. the interest compensation claim process), market participants should take every effort to avoid late payments. Late receipt of funds on settlement date often have the same impacts to those situations when funds are received the next day. This can include impacts to funding models, internal escalations and late payments to other market participants.

## Recovery of Funds and Interest Compensation Claims

As we have previously noted, whilst the proportion of payment errors remains low, when errors do occur, the payment risk remains outstanding until the issue is fully resolved (i.e. correct funds applied to the beneficiary and/or fully recovered by the remitting party). The industry therefore has the opportunity to reduce the amount and duration of residual risk from these erroneous payments, but notable challenges exist due to the lack of guidelines and standardisation – process, communication methods and timelines, across the global industry.

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[7] https://www.bis.org/publ/bcbs241.pdf
[8] https://www.globalfxc.org/uploads/fx_global.pdf

Pr55 in the Code states that: 'Market Participants should identify settlement discrepancies and submit compensation claims in a timely manner. Market Participants should establish procedures for detecting non-receipt of payments, late receipt of payments, incorrect amounts, duplicate payments, and stray payments and for notifying appropriate parties of these occurrences. Escalation procedures should be in place for liaising with counterparties that fail to make payments and more broadly for the resolution of any disputes. Escalation should also be aligned to the commercial risk resulting from fails and disputes. Market Participants that have failed to make a payment on a value date or received a payment in error (for example, a stray payment or duplicate payment) should arrange for proper value to be applied or pay compensation costs in a timely manner.'

To compliment Pr55, the GFXD Operations Committee has identified that the time taken to recover or/and return payments made in error is often inconsistent and is very manual in nature, often including multiple entities across the payment chain – e.g. multiple nostros and custodians. Typical delays are often attributed to:

- the time taken to recognise a payment has been made in error.
- the issuance and reconciliation of the payment recall or kickback messages.
- approval processes to agree the return of funds.
- the instruction and settlement of funds back to the remitter.

The use of automated and authenticated messages e.g. SWIFT, including new ISO200022 formats can be expected to expedite the issuance of a recall notice and subsequent kickback of funds. The inclusion of new and structured data attributes within ISO20022 will standardise the exchange of information, reducing any manual intervention and improving efficiency- therefore reducing risk exposure.

Feedback also suggests that smaller payments tend to be 'de-prioritised' and often inefficiently require more engagement to rectify promptly. In addition to the processes involved to ensure the return of payments made in error, additional reporting is often required as such errors could require reporting as a 'loss with or pending recovery' dependent on the duration.

Finally, if there is a related interest compensation claim, market participants can leverage the GFXD 2023 Guidance[9] and ISDA Suggested Operating Practices[10] to ensure timely resolution, clearly stating the compensation rate used such as i) overdraft / account funding charges, ii) use of funds (loss of interest) charges or iii) back valuation of the original payment.

## Conclusion

The GFXD Operations Committee support that FX payments made in error should be identified and returned as soon as possible, and no later than 5 business days.

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[9] https://www.gfma.org/wp-content/uploads/2023/04/guidance-for-resolving-interest-compensation-claims-apr2023.pdf

[10] https://www.isda.org/a/Sm6gE/ISDA-OTC-Derivatives-Interest-Compensation-Claims-Suggested-Operational-Practices-011122.pdf

Whilst this process is typified by the lack of industry-wide standards, the Principals within the Global Code and the 2013 Supervisory Guidance for Managing FX Settlement Risk should be adhered to in order to ensure that any risks are reduced as much as possible.

## Contacts

For queries about this document, please contact:


- Andrew Harvey / aharvey@eu.gfma.org / +44 (0) 203 828 2694