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# CASH MANAGEMENT

*The game changers in payments*



# BRINGING MARKET INFRASTRUCTURE UP TO SPEED

## ISO 20022

*As global market infrastructures modernise across the world, Deutsche Bank's head of market infrastructure and industry initiatives, cash management, **Paula Roels**, examines where the global banking industry stands in implementing the landmark ISO 20022 standard, the different approaches to its implementation and the critical factors for success.*

**BEHIND THE SCENES**, the global financial system is currently undergoing probably its largest, most far-reaching transformation in recent history. Multiple new market infrastructures, such as instant payments initiatives, are being implemented in many of the world's major markets, while existing high-value payments (HVPs) systems and central securities depositories are being upgraded to offer easier access, better services and lower transaction costs.

Underpinning most of these initiatives is ISO 20022 – an open, international messaging standard that defines key business processes and data, which is compatible with both mature and emerging technologies, such as blockchain and open application programming interfaces. ISO 20022 brings a host of benefits, enabling end-to-end business processes with high-quality data and no loss of information. It introduces a future-proofed payment standard that can be easily incorporated into existing back-office systems.

Its potential to transform market infrastructures is evident. In the next five years, it is predicted that the top five traded HVP currencies will have all moved to ISO 20022, as will 89% of the value of transactions worldwide. ISO 20022 is also the principal standard in the instant payments market, providing the foundation for implementations in Australia, the US, Canada, Sweden, Denmark and Singapore.

This is also the case in Europe. Both EBA Clearing's RT1 platform, which went live in November 2017, and Eurosystem's Target Instant Payment Settlement (TIPS), which is due to be rolled out in November 2018, are adhering to the ISO standard. Within securities market infrastructures, the investment funds industry has also adopted ISO 20022. Target2-Securities, Eurosystem's securities settlement system, processes more than 1 mil-

lion instructions per day using the standard.

Yet migration to ISO 20022 is not a trivial undertaking. It draws on bank budgets, requires widespread IT and architecture changes, and impacts business models – so care and co-operation are needed across the industry to ensure success.

### A THREE-PRONGED APPROACH

In Europe, Eurosystem is in charge of facilitating the migration to ISO 20022 messaging and plays three roles within market infrastructure and payments: as an operator, as a catalyst to foster change and integration throughout the market, and as overseer of various payments and securities systems.

Eurosystem has three significant modernisation projects under way as part of its Vision 2020 programme. Aside from TIPS, it is also consolidating the technical infrastructure of Target2, the Eurosystem's real-time large-value payments settlement system, and Target2-Securities. The last project is an upgrade of the Eurosystem collateral management system – not a market infrastructure per se, but rather a back-office system for national central banks, and one that stands to bring benefits to all parties through increased harmonisation.

The Eurosystem's ISO 20022 implementation will follow a 'big bang' approach, scheduled for 2021, yet different markets within Europe have their own requirements that need distinct approaches.

### THE SWISS MIGRATION

Within the European context, Switzerland represents an instructive case study of a successful market migration to ISO 20022. As one of the oldest real-time interbank settlement systems, the process of migrating to ISO 20022 began in 2010, with existing systems nearing the end of their lifespan in the face of sweeping industry digitalisation. »



THE EUROSISTEM'S ISO 20022 IMPLEMENTATION WILL FOLLOW A 'BIG BANG' APPROACH, SCHEDULED FOR 2021 **Paula Roels** ●●



## EARLY ENGAGEMENT OF ALL STAKEHOLDERS IS CRITICAL FOR ANY SUCCESSFUL ISO 20022 MIGRATION

Paula Roels ●●

With a proprietary message landscape that also needed replacing, and interoperability between the Single Euro Payments Area and the Swiss market a key requirement, the project needed careful handling, and therefore market participants took a longer term view.

A three-phase roadmap was drawn up. First, market infrastructures were brought onto ISO 20022; then the bank-to-bank space was addressed; and, lastly, so too was the customer-to-bank space, focusing on both payments and reporting. The process was a success, largely thanks to the new system's board of directors representing 85% of the market, meaning strategic discussions and decisions carried a high level of commitment, as well as the fact that the Swiss National Bank was involved early on as operator and supervisor, helping to ensure smooth progress.

Indeed, early engagement of all stakeholders is critical for any successful ISO 20022 migration, to ensure agreement on specifications and the overall roadmap. This is relatively easy in the bank-to-bank space since the parties involved view market infrastructure changes as mandatory. Corporates and their vendors, with no legal requirement to change, can be harder to persuade. They need to be convinced with hard facts.

This might not be a problem, however, as a cost/benefit study, conducted by Deloitte for the Swiss project, recently discovered. It found that, of the investment required, this was split roughly equally between banks and corporates. Yet the anticipated payback rate for corporates was much faster than for banks – two-and-a-half years compared with nine – which is a strong business case for corporates to change. And although this seems like bad news for banks, it should be remembered that the need to future-proof processes and replace legacy systems can often trump other considerations.

### LISTENING TO CLIENTS' CLIENTS


Market infrastructure modernisation has knock-on effects for all parties, and the feedback from Deutsche Bank's clients' corporate customers is clear in terms of what they expect from ISO 20022. Achieving straight-through processing and ending manual payments via numerous standards and multiple customised message pipelines are at the top of the list, as are moving towards consistent formatting standards and a consolidation of cash management transaction data flows.

Yet achieving these aims – and realising the benefits they will bring – requires orchestration and harmonisation on the part of banks, Swift and other institutions. Swift's community consultation in April 2018, which set out its vision for migration of cross-border services to ISO 20022, is a significant step in the right direction. With the formal consultation now complete, the results and a detailed roadmap for migration are expected to be released towards the end of 2018.

Additionally, in 2017, Swift formed the High Value Payments plus (HVPS+) task force, a global market practice group of market infrastructures and banks, including Deutsche Bank, that addresses the evolving ISO 20022 standards requirements of HVP providers and the need for interoperability, particularly considering increasingly global clients.

When it comes to implementation, as in the Swiss example, the importance of tackling market infrastructures first, then inter-bank and, finally, customer-bank infrastructure is a promising approach. Indeed, there are several international corporates that have implemented ISO 20022 before respective market infrastructures, leading to inefficiencies – so the need to prepare well is clear.

Common experiences need to be shared. Eurosystem, for example, is part of the Committee on Payments and Market Infrastructures and works closely with regulators in other jurisdictions. It also works with advisory groups at the Eurosystem level, with participants from the market side as well, who share knowledge, views and gauge interest in standardisation. And with HVPS+, Eurosystem is actively engaging with market infrastructures and industry representatives, such as Deutsche Bank, to jointly develop global standards in response to corporate clients' future needs.

Ultimately, collaborative efforts to establish market infrastructure services that ready the market for the rapidly changing environment must be encouraged. Migration to ISO 20022 is a large part of this effort, with its potential to deliver rich, structured information with a payment, and the flexibility to respond to future client needs and the future set-up of the financial market infrastructures. Yet different markets may require their own approaches. Market players should learn from those who have come before, keeping in mind the overall imperative of fostering collaborative efforts to share resources and knowledge where possible. 

# USING BLOCKCHAIN TO REVAMP CROSS-BORDER PAYMENTS

## *Distributed ledger technology*

*Is blockchain living up to its potential in revolutionising the cross-border payments space? Joy Macknight investigates how far the technology has come.*

**SENDING MONEY BETWEEN COUNTRIES** has long been ripe for disruption due to complex and opaque operations fraught with friction and frustration for both consumers and corporates. International payments lack visibility as to when they will reach an end beneficiary, as well as the amount intermediary banks might deduct in fees. In addition, they are costly and slow, which does not satisfy today's global e-commerce demands.

Take, for example, Booking.com, with property listings in 192 countries and territories. The travel e-commerce company must be able to make timely payments to its 28 million marketplace participants. "Booking.com is built on hundreds of millions of relatively low-value transactions. These are nuisance level international payments that are particularly poorly served by the current cross-border banking infrastructure," says Daniel Marovitz, vice-president of global payments at Booking.com.

There is a growing demand to move money "as seamlessly as e-mail moves today", says Jesse Lund, vice-president blockchain at IBM. "That is the target user experience being set by our customers." But even the fin-techs that have modernised cross-border payments from a user experience perspective, such as TransferWise and Currencies Direct, still use the 40-year-old rails.

The industry's imagination has been captured by the potential of blockchain, or distributed ledger technology (DLT), to solve these pain points at an infrastructure level. "The holy grail of cross-border payments is to make the payment messaging and the settlement of value happen together in real time on the same network. DLT has the ability to store and transfer value, along with payment instructions and messaging, as an atomic transaction that moves as fast as e-mail does," says Mr Lund.

### RECENT DLT INITIATIVES

The past five years have seen a groundswell of global payments initiatives using DLT. Proofs of concept and pilots have abounded, with



**DLT ELIMINATES FRICTION IN CROSS-BORDER PAYMENTS AND HAS THE POTENTIAL TO REDUCE INTERMEDIARY INEFFICIENCIES, COST AND RISK** *Jesse Lund* ●●

some projects moving into production mode.

For example, DLT-based global payments challenger Ripple claims that many of its more than 100 financial institution RippleNet members are already in production with its solutions. For example, SEB has processed more than \$1bn in payments over RippleNet between Sweden and the US. "Ripple experienced a banner year in 2017, in terms of customers going live," says Asheesh Birla, senior vice-president for product management at Ripple. He predicts even greater take-up this year.

And 2018 has started strong. In April, Santander launched One Pay FX, a real-time remittance service based on Ripple's xCurrent product, which allows the bank's

retail customers in the UK, Spain, Poland and Brazil to send euro and US dollar payments across the four countries. Santander UK customers can access this service via a smartphone app, with international payments reaching their destination in one day, versus three to five days on average for traditional wire transfers.

IBM's initiative, on the other hand, is still in pilot phase. In October 2017, it launched a DLT cross-border payments prototype, which is run on the IBM Blockchain Platform based on Hyperledger Fabric. "In this model, a digital asset, or tokenised representation of monetary value, is exchanged in real time as part of a series of operations that represent a transaction," explains Mr Lund. "It then becomes possible to achieve settlement with finality across borders where foreign exchange [FX] is just an implicit part of the transaction."

Expected to launch later in 2018, IBM's solution will bring banks and non-banks, including money transfer operators, into a common network "where they can interface with each other in a consistent way and transfer money to each other without having to have pre-negotiated agreements in place", says Mr Lund. The network will be open to money service providers and banking entities licensed in their jurisdictions.

### SOLVING FOR LIQUIDITY

Mr Lund reports that IBM has been working closely with banks and central banks over the past 18 months around introducing more liquidity measures into its network through issuing alternative digital assets such as stable coins, which are bank-issued assets that represent a claim on fiat currency deposits. "We are exploring the ability to introduce the equivalent of digital cash, which is not issuing a pure-play cryptocurrency, but one that acts as a bridge asset," says Mr Lund.

Ripple is also trying to solve the cross-border liquidity issue. While the xCurrent platform provides better information and processing for a payment, its xRapid >>





AT A HIGH LEVEL, DLT IS ALSO ABOUT INSTALLING SOME KIND OF TECHNOLOGY-BASED TRUST RELATIONSHIP

Jost Hoppermann ●●

product provides the liquidity for a cross-border payment by leveraging XRP, the digital asset, as a bridge currency, according to Mr Birla.

For example, Cullix, a US non-bank financial institution, is now using xRapid to make payments from the US to Mexico. Cullix can send a payment in US dollars, which gets converted into XRP through a digital exchange such as Bitso in Mexico, and then locally converts that XRP instantly into Mexican pesos to make the payment. "The whole process takes only a matter of minutes, down from a week or several days for a traditional overseas payment," says Mr Birla. "Cullix also saw significant savings, as it is much cheaper to use the digital asset to source liquidity than through conventional means."

xRapid is seeing greater traction among payment providers, including Currencies Direct, Mercury FX and Viameerica, whereas the banks are not quite ready to take the plunge into the nascent cryptocurrency space. However, Mr Birla reports that some banks using xCurrent are now looking to use xRapid for the second phase of their projects.

Mr Marovitz is interested in the idea of using a stable coin-type digital asset within Booking.com's marketplace to solve the FX issue. "There are many [things] to solve for FX, such as a consumer-focused FX forward or by securing US dollar-based asset in today's price with minimal FX variability. Or maybe there is a stable coin/reward points structure that could be used. It's a very real and complex problem, and there are no silver bullets," he says.

#### GOVERNANCE AND SCALABILITY

Despite recent advances, several issues need to be solved before DLT will see mass adoption in international payments, according to Jost Hoppermann, vice-president, principal analyst, at research firm Forrester. "Competing heterogeneous DLT payment initiatives are an obstacle to quickly reach the necessary critical mass. As DLT initiatives will mature and expand beyond the limited and limiting scope of a more proprietary ecosystem, another question comes into play," he says.

"At a high level, DLT is also about installing some kind of technology-based trust relationship. Will the industry need a version of Swift for the governance aspect, for defining and agreeing on a common set of data and process standards and rules and for running the network?" he asks.

Another issue is scalability. "Proven scalability concerns me because most pilot implementations are at very low transaction levels. I have yet to see any DLT implementation

that scales up in line with the typical millions of transactions in payments," says Mr Hoppermann. Likewise, Mr Marovitz is reserving his judgement on DLT's applicability in cross-border payments until the proofs of concept move into production and scale up.

Compared with Bitcoin or Ethereum's speed of less than 20 transactions per second, Mr Lund reports that IBM is seeing numbers around 4000 transactions per second, which is impressive given the few years of development. And he is optimistic that the scalability characteristics of DLT will improve as the industry matures and develops next-generation DLT-based payment networks.

Mr Birla says that Ripple developed its technology with scalability in mind. "To deploy something for Standard Chartered, Santander or Bank of America, our solution needs to scale to hundreds of thousands of transactions per second – this was in the design from the outset," he says.

#### TARGETING THE UNDERSERVED

Many believe that DLT could help address the gap in cross-border payment services created by the withdrawal of correspondent banks 'de-risking' their operations. Mr Lund says: "DLT eliminates friction in cross-border payments and has the potential to reduce intermediary inefficiencies, cost and risk. So, financial institutions that may not want to set up shop in certain jurisdictions because of economic risk are more able to participate as lenders, liquidity providers and payment service providers in those countries."

DLT also opens up market access to new entrants, such as BitPesa, for example, which uses Bitcoin as a bridge currency for cross-border payments to and from Africa. In January 2018, BitPesa purchased TransferZero, an online money transfer company, and recently launched a white-label product that will leverage BitPesa's compliance, processing capabilities and pay-out network across Africa. "We are looking to work with tier-two and tier-three banks in Africa that aren't connected to Europe and other remittance destinations," says CEO Elizabeth Rossiello, adding that this will help address the correspondent banking gap.

Ripple is also looking to expand in these jurisdictions. Mr Birla says: "E-commerce and digital marketplaces want to send payments to emerging markets because that is where growth is. Banks want to develop new businesses and grow their pie. And regional banks are important components of our ecosystem." TB

# CORRESPONDENT BANKING STEPS INTO A NEW ERA

## *Cross-border payments*

*Correspondent banking relationships may have been scaled back because of a stricter regulatory environment since the financial crisis, but a refocusing of bank strategies, close industry collaboration and exciting new technologies are ensuring cross-border payments are keeping up with the demand. Christian Westerhaus, global head of clearing products, cash management, at Deutsche Bank explains why the future is bright.*

IT IS NOT NEWS that correspondent banking has come under pressure in recent years. Increased regulations, sky-high customer expectations and fresh competition have thrust this traditional banking model into the spotlight. Yet for corporates settling cross-border payments, it remains the go-to mode of payment, with most of their international payments being settled bank-to-bank.

New initiatives are coming to the fore in this rapidly changing environment. For example, Swift global payments innovation (gpi) joins payment intermediaries via a cloud-based cross-border payments tracker (see interview with Swift's Wim Raymaekers on page 113).

Swift reports that 50% of gpi payments are credited in less than 30 minutes and approximately 92% within a day, which has had a dramatic impact on the industry. Banks can credit payments within minutes or even seconds, while their customers benefit from shorter supply cycles and can get down to the business of shipping goods much more quickly.

### HEAVY TRAFFIC

The correspondent banking industry is aware that the speed, transparency and traceability of cross-border payments are hot topics when it comes to customer expectations, but the nature of correspondent relationships must not be overlooked: maintaining the size and reach of the network is vital. The Swift network, which is the way financial institutions reach one another today, certainly has this reach, handling a large amount of traffic.

In April 2018, Swift recorded a daily average of 30.62 million FIN messages, which transmit information from one financial institution to another. In addition, traffic grew 12.1% in the year to June 2018, with reporting messages contributing 50% of this growth and representing 47% of the total traffic.



**COUNTERPARTIES ARE  
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TRACE THEIR PAYMENTS**

*Christian Westerhaus* ●●

It is not yet clear how alternative payment providers outside the network can attain the same level of reachability. Merely offering connections to single banks is not enough.

Counterparties are also now increasingly demanding in terms of being able to track and trace their payments, and want assurance that the network is secure. Swift gpi not only provides this, but provides greater visibility over transaction fees and foreign exchange rates.

This, along with payments intermediaries being connected on one system, drastically reduces the time it takes credits to reach beneficiaries, from days to less than 30 minutes. This usually results in banks crediting funds on the same day of receipt. Thanks to Swift gpi, corporates and financial institutions are operating in an environment that paves the way for growth and efficiency unseen before.

### A REGULATORY BALANCE

Stricter regulations affecting correspondent banking have come largely in the form of know-your-customer requirements and anti-money laundering controls. Ensuring effective compliance, while essential for the safety and integrity of global payment networks, can require significant time and budget commitments from banks.

While this is certainly true in the global cash space, the largely paper-based trade finance space – although slowly digitalising – has perhaps suffered the most. Collecting data and cross-checking reams of documentation to ensure compliance is a serious effort, pushing up transaction costs, and many banks have understandably had to scale back correspondent relationships.

The Financial Action Task Force has been active in addressing this problem. It has highlighted how derisking can increase the number of payments in less regulated channels, reducing transparency and excluding certain parties, in turn raising money laundering and terrorist financing risks, a counter-intuitive possible result of increased regulation. It advises financial institutions to fully identify and understand terrorist financing and money laundering risks, and implement the necessary preventative measures.

### BETTER RELATIONSHIPS

Banks that are scaling back are therefore prioritising deeper, more strategic global financial institution partnerships within existing correspondent networks, assessing which contracts offer the most value, then realigning efforts accordingly.

Swift's paper 'Correspondent Banking 3.0' breaks correspondent banking relationships into three tiers. The first is partner banks, where there is a strong relationship and usually a focused geographic presence, so that they can handle high payment volumes across many products. Second is specialist correspondent banks, which have strong expertise in specific products. The third tier is coverage banks, which enhance the geographic footprint of a bank where it might not have a presence.

Correspondent banks, such as Deutsche Bank, are using such frameworks and other resources to turn the challenge into an »



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**Christian Westerhaus** ●●

opportunity, not only managing and mitigating risk so that they are compliant with regulations, but also ensuring these measures increase efficiency and support growth.

This means communicating risk tolerance standards to other financial institutions via policy statements on prohibited or high-risk transactions, for example. Such measures help correspondent banks not only to identify new risks, but increase the capacity for financial institutions to comply.

#### **CUSTOMER DEMAND**

In addition to compliance, digital advances are driving corporate demand for better pricing, speed and transparency of services. Yet the complexity of large corporate treasury structures means that fully integrated, highly refined solutions are the only way to solve their liquidity and working capital problems. As such, third-party instant digital payment providers and fintechs do not yet pose a threat to correspondent banks, who can leverage their vast networks and expertise.

But banks should not rest on their laurels. Cross-border payments and foreign exchange simply cannot return to the times when beneficiary accounts took a week to be credited as they wound their way through opaque, long-winded banking chains.

Swift gpi has gone a long way to ensuring this will not be the case. The gpi Tracker, for example, enables end-to-end visibility of a payment through status updates of unaltered remittance information and transaction costs, and can be updated by FIN message or application programming interfaces and accessed via a graphical user interface, ensuring interoperability with back-office systems. This has met customer demands for transparency, just as same-day clearing of funds across the world has met those for speed.

#### **TAKING STEPS WITH TECHNOLOGY**

At the heart of the modernisation of correspondent banking is technology. No technology has generated more interest in the corporate sphere than blockchain, a form of distributed ledger technology (DLT) that is already making its first appearances in real trade finance deals, following a series of successful proofs of concept.

Beyond this, blockchain lies at the heart of several initiatives. For example, blockchain-based We.trade is a joint venture between nine banks – built specifically with mid-caps and small and medium-sized enterprises in mind – that links trading partners across a supply chain.

Swift has also considered DLT, having

recently completed a proof of concept to test whether nostro account owners and their service providers could share a private, confidential ledger recording transactions related to their nostro accounts. The solution harnesses gpi technology and ISO 20022 messaging standards to create a unique end-to-end transaction reference with integrated intraday liquidity standards.

These are promising innovations, but the banking industry must be pragmatic when looking at the timeline. In the long term, blockchain initiatives and other innovations have the potential to reshape banking models, but the evolution will be neither quick nor easy, particularly given the structures of today's regulatory environment. To overcome this, each step forward must be considered and effective, with the aim of solving client challenges the driving influence behind every new step.

There will be other challenges. Solutions initially tailored to an individual client's needs and fine-tuned for compliance must be reinforced to handle larger sums of money at higher volumes before they can be rolled out to the wider market for international trade. Likewise, solutions must be comprehensive in geographical scope, offering full connectivity across countries, currencies and bank accounts around the world.

#### **AN AI FUTURE**

With an eye on the near term, however, there are other innovations that can already be adopted more widely. Artificial intelligence, for example, promises to increase efficiency and reduce costs for risk management processes. Artificial intelligence systems can learn typical patterns and trends in the movement of money – highlighting potential risks before they emerge – and analyse contextual data surrounding a counterparty to generate a refined risk score for a given partner or transaction.

These are just a few factors contributing to the ongoing modernisation of correspondent banking. At a time when efficiency is of immense importance, technology is driving these improvements and simplifying processes across the board, and has the potential to underpin a dramatic overhaul of the banking landscape over the next decade or so.

The transformation will be gradual and at each step along the way the industry must prioritise moving funds as securely as possible. It is on this foundational principle that the infrastructure of a new correspondent banking era can be built, and realise the long-sought benefits of speed, efficiency and transparency. **TB**



# WIM RAYMAEKERS

## Interview

Swift, together with 45 member banks, launched the global payments innovation (gpi) initiative in early 2016, to increase the speed, transparency and predictability of cross-border payments. More than 180 banks have signed up to the service, with over 60 banks now live. As of May 24, 25% of all Swift cross-border payments traffic is now being sent as gpi. *Joy Macknight* talks to Wim Raymaekers, Swift's gpi programme director, about the latest developments.



**BANKS ARE REPORTING A 50% TO 60% REDUCTION IN THE NUMBER OF ENQUIRIES COMING FROM OTHER GPI BANKS** *Wim Raymaekers* ●●

### Q What major milestones has Swift gpi achieved to date?

A Following a general agreement around gpi's basic business rules, we launched a pilot in February 2016 and the first live messages were exchanged at the end of that year. The speed of action is testament to the urgency [felt by the banking industry], but also that we got the architecture right. We developed gpi on the current rails because we couldn't wait until new technologies became bank-grade ready.

Another highlight was the launch of the [real-time] Tracker in May 2017. From the outset, we had an agile release plan. We first went live with basic features and then extended the Tracker's functionality in November 2017, and again twice this year so far. Last year banks could send gpi payments to all Swift users, and now even non-Swift flows can be monitored by the Tracker, such as payments over The Clearing House Interbank Payments System and Fedwire.

Achieving these major milestones has driven the adoption of gpi to such an extent that our member banks expect gpi to be the new norm within the next two years.

### Q Why is it proving so popular for banks and corporates alike?

A Swift gpi is solving a real problem in a real way. Banks are reporting a 50% to 60% reduction in the number of enquiries coming from other gpi banks because they are using the Tracker. In addition, banks were able to go live within three to six months because gpi relies on the existing rails, as well as the banks' current back office, foreign exchange, compliance, etc.

Importantly, Swift gpi is independent of the underlying technology. We can go live with what we have today or with new technologies that are deployed tomorrow. It is even independent of the MT103 [Swift message for making payments], so we could move to ISO 20022 XML standard tomorrow.

The tracking information is proving popular with corporates, as well as the confirmation

when the payment reaches its destination. A major bank in Canada reported that its corporates want the Tracker information all in one screen, so they can print the screen and send it to their trade counterpart as proof the money has been credited. Previously, they didn't have the certainty of a payment.

More than 40 banks are integrating the gpi experience into their banking portals – and 15 already have – so that corporates can access the gpi Tracker results directly. Corporates like the ability to self serve, as well as the predictability and transparency of gpi. We are currently doing a pilot with corporates, including GE, Microsoft and Booking.com, so that they can receive the gpi information from their banks directly into their treasury management and enterprise resource planning systems. These large corporates want a standardised experience across their banks, for many have up to 50 or more banking relationships.

### Q What new gpi elements are coming live this year?

A First, the gpi UETR [unique end-to-end transaction reference] will be put on all Swift payments by November. All 11,000 institutions on the Swift network must be ready to use UETRs in their payment messages, including non-gpi banks. This is an important change because it then becomes possible to launch new services based on the UETR.

Next, we'll launch three new services. The first is called extended tracking. When the UETR is added to every payment there will be 100% tracking of 100% of payments on Swift, end to end throughout the whole chain.

The second service is the ability to stop and recall a payment. Today, a corporate must ask its bank to chase a payment from bank to bank. But with the Tracker, they will know exactly where the payment is stopped, if need be. In addition, Swift gpi will put a stop on the network so it cannot be forwarded inadvertently. >>





WE ARE WORKING WITH  
BANKS IN AUSTRALIA, CHINA,  
SINGAPORE AND THAILAND  
TO CREATE A REAL-TIME  
CROSS-BORDER SERVICE  
ACROSS ASIA-PACIFIC

Wim Raymaekers ●●

The third is gCOV service, which will encompass MT202 cover messages [which order the movement of funds to the beneficiary institution via an intermediary bank].

**Q How is Swift engaging with the fintech community to develop the gpi platform?**

**A** In June 2017, Swift launched its global gpi industry challenge and three months later choose two winners [AccessPay and Assembly Payments]. We are now doing a proof of value with these fintechs, a group of banks and corporates. We are exploring opportunities and, if there are some, then we will move forward with a proof of concept [PoC]. Our methodology is to co-create with banks, fintechs and corporates.

In addition, we have extended a broad invitation to fintechs to exhibit in the Discover Zone and Fintech Marketplace at Sibos 2018 in Sydney, Australia. We will pitch gpi to them and they will pitch their ideas to us, and we will see if there are opportunities to explore.

**Q Is real-time cross-border payment capability the direction of travel for Swift gpi?**

**A** On my recent trip to Asia, we conducted a workshop on real-time payments. One of the main benefits of Swift gpi is faster cross-border payments – many are happening in seconds and nearly 50% are credited within 30 minutes. And if there is a domestic real-time system behind it, then it is also 24/7.

This is important as it allows the receiving bank to expand the operational window and credit a payment that day. The average real-time gross settlement system has a cut-off time of 4pm to 5pm. Previously, if a bank in China sent a payment to Australia after 5pm, it would be credited the next day. But with a 24/7 system, such as the New Payments Platform in Australia, a Chinese corporate can ask its bank to send a payment much later in the day and still have the same day value.

That is where Swift gpi is heading. We are working with banks in Australia, China, Singapore and Thailand to create a real-time cross-border service across Asia-Pacific. Connecting the cross-border gpi to domestic New Payments Platforms is a good first step, especially with Sibos being in Australia this year.

This provides a richer, more valuable story than just sending a payment in a few seconds. It is about being able to send payments longer throughout the day and not

having to consider cut-off times in other countries. So, yes, we are travelling in the direction of real time, combined with extended opening hours.

**Q How does Swift gpi fit into the context of the move to Open Banking and open application programming interfaces [APIs]?**

**A** APIs are a cornerstone in the gpi technology strategy. Banks are adopting the gpi Connector, enabling API integration. We are also exploring how to add more services at the edges so that corporates can, for example, perform a request for payment using an API. Or if there is an important payment on the way that corporate is waiting for, it can use an API call for information from its bank, or the bank could send an API alert.

We will move towards a more open API model in the future, but we aren't quite there yet. While Europe is pushing in that direction with the Payment Services Directive 2 [PSD2] and we see developments towards Open Banking in other parts of the world, there is not yet a global PSD3. But APIs are something we have already embedded in gpi for the portal integration and banks are looking to expose the API experience to their corporates.

Swift embraces API technology and sees its potential in unlocking the financial services industry, more so than blockchain for wholesale cross-border payments, for example.

**Q But does blockchain, or distributed ledger technology [DLT], have the potential to replace the correspondent banking network?**

**A** When we performed a DLT PoC a year ago, we found that to have intraday liquidity, a bank's back office must generate liquidity reports, or updates, on an intraday basis. So, banks must change their back office to generate and process debits and credits on a transactional basis. If they don't, then using DLT is not going to make a difference.

That was one key conclusion. At the same time, we decided to continue to explore the applicability of DLT from a technology maturity point of view. So, it is too early to make a definitive comment on DLT.

Nevertheless, the beauty of gpi is that it is technology- and format-agnostic. And it adds real value to the end customer, which is what both banks and corporates are looking for. Together with the industry, we can figure out the best technology and standards to suit cross-border payments in future. **TB**



# KYC – WHY NOT COME TOGETHER?

## *Know your customer*

*With the cost of know-your-customer compliance increasing, sharing client information to a standard everyone trusts makes absolute sense. Katja Zschieschang, Deutsche Bank's resident KYC expert, looks at the benefits of a collaborative approach to data collection to help reduce the costs of compliance.*

AN ACCELERATED DEVELOPMENT OF GLOBAL STANDARDS for the sharing of customer information is providing a welcome addition for what has long been a burden for correspondent banks. In February 2018, the Wolfsberg Group of 13 banks announced that it had revised its Due Diligence Questionnaire (DDQ), a de facto standard for correspondent know your customer (KYC) due diligence information.

Global regulators, including the Financial Action Task Force, the Financial Stability Board Committee on Payments and Market Infrastructures (CPMI) and the Basel Committee on Banking Supervision, have already given this a nod in a joint press release on March 8 endorsing the updated DDQ.

The revision has been welcomed for the simple reason that full customer knowledge – in the form of detailed checks to a specified level of granularity – has stretched even the most established financial services providers. It has been particularly difficult for correspondent banks to achieve, and causes headaches for their customers, too.

At its core, KYC means banks must take the necessary steps, both in terms of compliance frameworks and related processes, to understand the risks inherent in the payment flows of not only their own clients, but also their clients' clients. This is a significant challenge made more difficult by the vast data collection requirements that it inevitably demands. Failure to do so not only increases the risk of fraud, cybersecurity attacks and other operational hazards, but it also lays the bank open to steep fines, as regulators raise the bar in protecting consumers, increasing transparency and tackling financial crime.

According to Swift, there are 1.3 million bilateral correspondent relationships across the banking industry. As Swift notes, this creates a huge administrative burden for banks each time a relationship is added, or information needs updating.

A ramp-up in due diligence obligations over the past decade impacted data collection workloads, demanding correspondent banks take the necessary steps to understand the risks inherent in the payment flows of their

clients' clients. Furthermore, this all must be done in the context of multiple sanctions regimes and fraud prevention requirements. Thus, third-party tools and capabilities have emerged, offering the means to exchange and verify KYC data cost-effectively and monitor transaction flows through data analytics to ensure continued compliance.

### SHARED ASSESSMENTS

Knowing your customer makes sense from a commercial as well as a risk management perspective. But proving full compliance with KYC legislation across multiple jurisdictions can thwart commercial imperatives. For many correspondent banks, the natural consequence of heightened KYC obligations – and the associated costs – has been strategic de-risking. It is inevitable that banks will evaluate the commercial value of a relationship against the cost of maintaining it, leading to some withdrawing from selected relationships and markets.

Manually conducted KYC checks, which are subject to different processes and >>



**MANUALLY CONDUCTED KYC CHECKS ARE COSTLY AND CAN PROHIBIT PROFITABLE SERVICE DELIVERY** *Katja Zschieschang*

requirements across product lines, client groups and markets, are costly and can prohibit profitable service delivery. Banks have improved their processes and coordination to manage higher data volumes. Many banks, including Deutsche Bank, initially took on more human resources to capture the required data and evaluate in line with increasing regulations.

But now it is important to improve on how information is collected and reviewed. Rather than several different departments sourcing the same or similar data, banks should share core information internally, then request more specialist, product-specific details if necessary.

#### CAN UTILITIES HELP?

For correspondent banks that must 'look through' partner banks to understand their exposure to underlying clients, the cost/benefit analysis of relationships has come under intense scrutiny. In a 2016 report by the CPMI, correspondent banks cited rising compliance costs as the 'most common cause' of reduced profitability. Many were also uncertain on how to achieve KYC compliance, in particular flagging the required depth of knowledge on clients' clients. The report also noted this uncertainty increases the difficulty of measuring risks and might be leading to the abandonment of some relationships.

Receiving information from banks in different formats can very quickly become problematic in an environment comprised of multiple correspondent relationships and a vast flow of information. It can be a significant operational challenge if banks all ask slightly different questions of their counterparty banks, or if they answer those questions using slightly different definitions.

The CPMI report backed several collaborative initiatives aimed at more effective information sharing, notably greater use of utilities serving as shared central repositories of KYC due diligence data, with the aim of reducing the time and cost spent sourcing and preparing information bilaterally.

With a utility, such as Swift's KYC Registry, the questions and terminology can be standardised, so that all participants develop a common understanding. Such utilities also bring benefits for Deutsche Bank's financial institution clients. Those that make their data available via the KYC Registry benefit from a streamlined review as part of the regular KYC process the bank has to undertake.

#### INFORMATION STANDARDISATION

To ensure standardisation of the KYC data shared between correspondent banks using

its KYC Registry, Swift has established a working group of global transaction banks, including Deutsche Bank. This means that any bank requesting KYC data from the utility on a correspondent is guaranteed to receive a 'baseline' of Swift-verified information across five categories:

- Identification of entity;
- Beneficial ownership structure and key controllers;
- Products and services;
- Anti-money laundering policies and compliance structures; and
- Tax information.

A further step towards standardisation was made in October 2017 when the Swift KYC Registry was aligned with the recently revised Wolfsberg's DDQ. This means users can complete the questionnaire directly via data contained in the utility.

This collaborative approach has yielded significant benefits: the working group has identified the need for timestamps on documents, for example. The next priority is to explore the use of application programming interfaces (APIs) to pull data from the KYC Registry directly into the bank's internal systems, although this may be a longer term project.

The Swift working group is keen to see as many correspondent banks as possible using the KYC Registry, but there has been some resistance from smaller banks on account of the upfront costs. However, it is hoped that ongoing efforts to explain the security and standardisation benefits of sharing data via a dedicated utility – rather than bilaterally over e-mail – will overcome these reservations.

So far, the KYC Registry is the only utility to have aligned its data 'baseline' with the updated DDQ and it remains to be seen which other utilities will take a role in supporting this industry standard.

#### A SILVER BULLET?

As utilities continue to drive adoption among correspondent banks and forge interoperability among those banks through new technologies, their support – from both the public and private sectors – continues to grow, as evidenced by the Wolfsberg Group.

In addition to this, more interoperability through APIs and the exploration of distributed ledger technology will likely foster greater support for utilities in future. While these advancements do not necessarily present a silver bullet for KYC, they are nevertheless a valuable set of weapons in the fight against financial crime. **TB**