

REAL TIME CROSS-BORDER PAYMENTS AND CBDC



The Future of Clearing in a World of CDBC and Real-Time Payments

The past ten years have brought disruptive technologies like blockchain, shared ledgers and new ways to build applications to the mainstream. The pace of technological change is such that twenty-year-old legacy implementations are considered antique, sometimes even when they are perfectly fit for purpose.

The expectations around speed and availability of services have kept pace with the development of technology, although on occasion this expectation has evolved faster than the implementation of that technology.

The panel organised by EPA Asia, “The Future of Clearing in a world of CDBC and Real-Time Payments”, brought together industry experts from several Asian countries to discuss the evolution of payment technology and, specifically, the impact of retail and wholesale users’ expectations over cross- border payments, and how the influence of CDBC will affect the evolution of clearing cross- border payments in Asia.

Asia is a very interesting environment for cross-border financial transactions. The United States is a geographically large market in one legal jurisdiction; in Europe, the Single Market in Financial Services has created a single regulatory framework and one de-facto jurisdiction for 27 countries. In Asia, there are several countries, all with very active financial markets, and several jurisdictions. Each jurisdiction has a regulator, and regulators can both trigger and slow down change.

Anti Money Laundering (AML) in Cross-Border Transactions

Issues like ownership of data and Anti Money Laundering (AML) create practical problems in cross-border transactions. It can be complicated to decide who “owns” the information and therefore access to information from a different jurisdiction may be difficult. There is not a common database for KYC or AML checks, and – last but not least - process-to-process information ‘owned’ by a subject that resides in another jurisdiction can create a lot of bureaucratic issues.

Those are all issues that can be solved, but their solution extends the time it takes to process a payment, moving it away from “real-time”. However, the public has come to expect the same level of service for cross-border payments as the ones already established for domestic transactions. Some of the complications of crossing legal jurisdictions have been dealt with on a country-to-country basis, such as the interconnection agreement for real-time payment between Singapore and Thailand (PayNow and PromptPay). There are also other agreements to connect payments between different countries like Singapore to Malaysia, Malaysia to India and Singapore, and more.

Legacy systems represent a problem for innovation. They are still fit for the present and banks may be reluctant to replace them and not just on account of costs. It may not be straightforward to interface a legacy system with a system based on new technology, the best solution would be not to interface it and “assign” different tasks to each one. For instance, in the future, SWIFT may be reserved for the large wholesale transfers of funds, leaving smaller real-time transactions to new technology.



However, retail transactions are not the only ones that feel the pressure of real-time processing. In the DVP (Deal Versus Payment) environment, where the exchange of an asset could happen faster than the exchange of value, there is a need for a regulatory change to allow for instantaneous transfer of value. Regulated assets and unregulated assets present different challenges. The current regulatory environment dictates the time for clearing and settlement of regulated assets; unregulated assets may not have the same regulatory constraints but present a higher risk of fraud.

One of the panelists made the point that the overall infrastructure “needs to catch up with customer needs and customer demands”. There are usually one or more of three possible reasons behind the adoption of technology not growing as fast as we expect:

- 1) The demand is not there**
- 2) Change management is not there**
- 3) Competition (among adopters) is not there.**

As far as global payments are concerned, today the competition between potential adopters is starting to take shape. Many organisations are putting together programs. For instance, JP Morgan is making a large investment in change management (12 billion) towards the adoption of next-generation banking and infrastructure for web 3.0. This investment will have a huge impact both on the retail and the wholesale elements of the bank. Last but not least, there definitely is customer demand for instantaneous money movement. The move towards next-generation banking and infrastructure brings issues of increased liability, increased risk, and the need for regulatory change to match the compliance framework with the next-generation environment.

Disruption

The rise of e-currencies is perhaps one of the most disruptive developments in the evolution of global payments. Financial regulators are beginning to tackle the risks associated with private, and therefore unregulated, cryptocurrency. They have not yet looked at issues generated by Central Bank Digital Currencies (CBDC) such as the potential loss of anonymity of retail cash transactions and the consequences of disintermediation for the banking system.



There are several pilots around the world, the largest being China where the eECMY was launched during the winter Olympics. The Bahamas and other countries in the Caribbean have launched the Sand Dollar CDBC, but the most interesting case is in Nigeria with the eNaira.

The disappearing anonymity

Nigeria is interesting because it is a developing economy. In developed economies, cash transactions are only a percentage of the total retail transactions due to the wider use of card payments even in brick-and-mortar establishments. Developing economies are still cash-based, the nature of blockchain technology is transparency and accountability - there is no anonymity in a blockchain transaction. Many pilots plan to start with transactions that are not anonymous already, for instance, welfare disbursements or tax collection. These pilots will have to sort out what happens to the e-currency after the initial disbursement because it will be possible to see how the money is used if one has the key to access the chain, equally it will be possible to see where the e-cash used to pay taxes come from. The disappearing anonymity lends itself to a deeper conversation about Digital Identity, the subject of many debates, especially over financial inclusion. One of the challenges is to shift all the identity checks that are currently taking place in a financial transaction towards digital identity and how to protect this identity from cyber threats.

The impact of disintermediation on the banking system remains to be seen, CBDC and private e-currency do not need banks. Traditionally, banks lend the money they collect. As CBDCs take a larger portion of cash transactions, the cash deposited in banks will decrease. What will happen to retail lending then?

Maybe the role of banks will change? Somebody will have to hold the wallets, and be the custodian where CBDCs are kept on behalf of customers and businesses.

Who will manage the digital equivalent of a bank account?

The wallets of unregulated e-currencies are held in people's laptops with all the risks that come with them. Wallets holding CBDCs have to be more protected and more secure than a USB stick. Although there is not a specific agreement between central banks, the trend seems to be that banks will have a role in holding these wallets. So, disintermediation may not be such an issue as far as CBDCs are concerned.



On paper, the use of CBDCs should simplify global payments. In reality, this depends on agreement between central banks. The technology for interoperability among blockchains is still at its infancy: to use eCMY for a cross border payment it is necessary to have access to a wallet that can hold eCMY in the chain used by eCMY.

A panelist mentioned agreement between central banks, that would be necessary to make it possible. It may be too early to make an informed guess as to where things will end up. It will be interesting to see what happens now after the winter Olympics. China's pilot is possibly bigger than the programs launched by Nigeria and the Bahamas. The Chinese authorities have stated that the eCMY will not circulate outside the country. We are yet to hear what international visitors to the Olympics have done with any leftover e-cash in their wallets. This will give us an indication as to the possible use of CBDCs globally.

Conclusion

CBDCs can have an enormous impact. They can alter how payments and money works, and implementations may entrench the status quo or disrupt it entirely, so implementing a CBDC is not just a black and white decision, with many shades to chose from, it is important that regulators make choices that can have the most beneficial impact. Early implementations of CBDCs will be trial and error and each experiment could provide a lesson for future implementations anywhere in the world - which is why collaboration, communication and transparency are important as we collectively discover an ideal solution.

In order to aid the discussion, EPAA will be producing key policy and design considerations regulators should consider when implementing a new CBDC.

We always turn to our members for thought leadership

Thank you



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