

CAPCO

INSTANT CROSS-BORDER PAYMENTS: TRANSFORMING GLOBAL COMMERCE



a **wipro** company

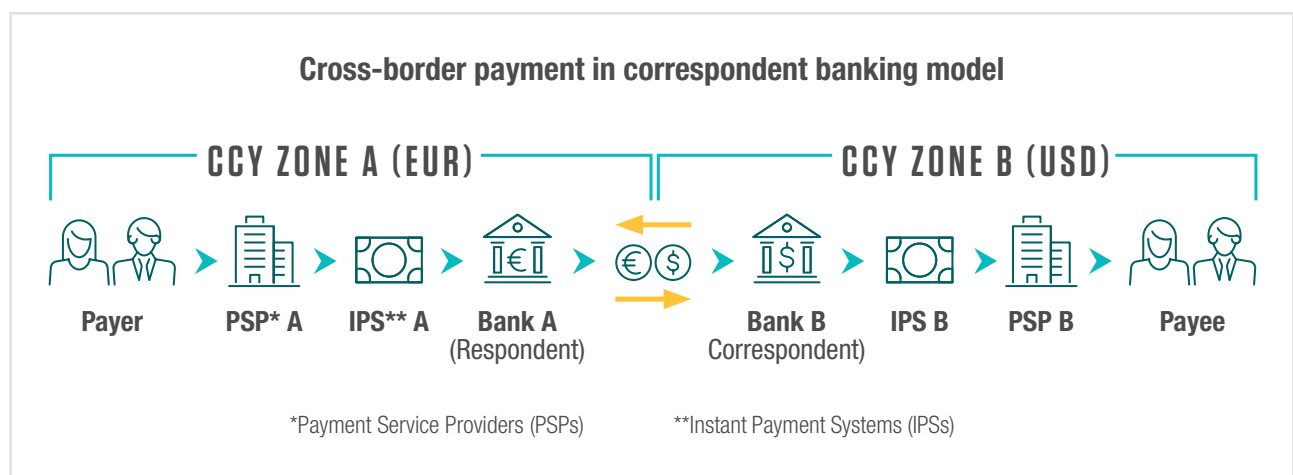
Cross-border payments are crucial for international trade. However, traditional cross-border payments still take a long time (several days), attracting high fees between the correspondent and partner banks while lacking transparency in fee structures and exchange rates. Divergent regulatory environments present additional challenges for businesses and individuals, making cross-border transactions more susceptible to fraud and complicating dispute resolution.

With the advent of digital technology and financial innovation, the tide has started to turn. Fintech companies, blockchain technology, and new regulatory frameworks are paving the way for instant cross-border payments, bringing a myriad of benefits to individuals and businesses alike.

The global trade market is projected to grow from \$190 trillion to \$290 trillion by 2030, with business-to-business (B2B) payments increasing from \$39.3 trillion to \$56.1 trillion.¹ B2B payments, particularly in e-commerce, will dominate, highlighting the need for efficient, secure and instant payment solutions to support global business operations.

MODERNIZING CROSS-BORDER PAYMENTS

For many decades, traditional cross-border payments have been processed through correspondent banking networks, primarily using systems like SWIFT (Society for Worldwide Interbank Financial Telecommunication), which was established in 1973. These payments often take many days to reach the beneficiary and are associated with high costs.



Today's instant cross-border payments can leverage several technological advancements to achieve speed and efficiency.

Blockchain technology: Blockchain offers a decentralized and secure way to record transactions. By eliminating intermediaries, it speeds up the payment process and reduces costs. Cryptocurrencies like Bitcoin and Ethereum are often used for cross-border transactions due to their global reach and quick settlement times.

Fintech innovations: Companies such as TransferWise (now Wise), PayPal, and Revolut use sophisticated algorithms and local banking networks to expedite payments. By pooling resources and utilizing peer-to-peer networks, these platforms can offer near-instant transactions at a fraction of the traditional cost.

In addition, governments and regulatory bodies are recognizing the need for efficient cross-border payments. Initiatives like the European Union's Single Euro Payments Area (SEPA) One-Leg Out Instant Credit Transfer (OCT Inst) have standardized and simplified payments across member countries, promoting faster and more reliable transactions.

BENEFITS OF INSTANT CROSS-BORDER PAYMENTS

Speed and efficiency

The most obvious benefit is the drastic reduction in transaction times. Payments that once took days can now be completed in minutes or even seconds. This is particularly advantageous to help businesses manage cash flow and for individuals in need of urgent funds.

Cost reduction

By cutting out intermediaries and leveraging technology, transaction fees are significantly lowered. This is a boon for businesses dealing with thin margins and individuals sending remittances where every penny counts.

Transparency and security

Modern payment platforms offer real-time tracking and confirmation, providing transparency throughout the transaction process. Additionally, advanced encryption and security protocols ensure that funds are transferred safely, reducing the risk of fraud.

Global reach

Instant payments are not limited by geography. Whether paying a supplier in China or sending money to family in India, the global network of digital payment platforms ensures that money reaches its destination quickly.

MODELS TO ACHIEVE CROSS BORDER INSTANT PAYMENTS

A recent study observed that over 80 countries have a live domestic instant payment network. Thus, around 75% of the world population have access to instant payments.²

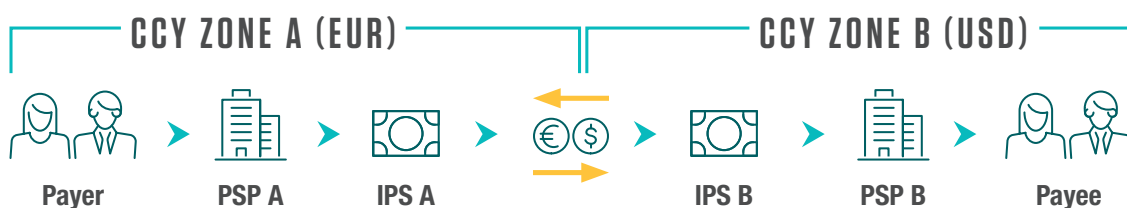
One of the big challenges is to interlink the different domestic instant payments systems to be able to make cross-border payments instantly between countries and currencies, without correspondents and partner banks. Below we examine key models available.

Interlinking model

The interlinking model connects the domestic instant payment systems (IPSs) of two or more countries without requiring

correspondent arrangements. This simplifies cross-border payments for payment service providers (PSPs) without a local presence. This model reuses existing IPS infrastructure and the associated bank services, including AML/KYC processes, but faces challenges in establishing compatibility across different IPSs, with the number of links increasing manifold with the growing number of participants, leading to diverse data formats. Currently, only a few IPSs are interconnected, so a scalable approach to a global cross-border payment network is required.

Cross-border payment with interlinking model



Institutions such as the European Payments Council (EPC) and Bank for International Settlements (BIS) have started projects – projects SEPA OCT Inst and NEXUS – to enable instant cross-border payments.³

SEPA OCT Inst

To make cross-border payments within the SEPA area more attractive and faster, the European Payments Council introduced SEPA One-Leg Out Instant Credit transfer (OCT Inst) payments service. The EPC is responsible for managing the SEPA schemes, which include standards for euro payments across the SEPA area.

SEPA OCT Inst refers to cross-border payments within the SEPA area where only one of the involved parties (payer or recipient) is located within the SEPA area. The SEPA OCT Inst service was developed to extend the benefits of SEPA Instant Credit Transfers (SCT Inst) to cross-border payments involving non-SEPA countries, thus enabling faster and more efficient transactions even when one party is outside the SEPA region. With OCT Inst, transactions may involve currency conversions if the recipient country uses a different currency.

The first international instant payments with the EPC's SEPA One-Leg Out scheme launched in Europe by Santander Bank and Iberpay in May 2024.⁴

Nexus Project

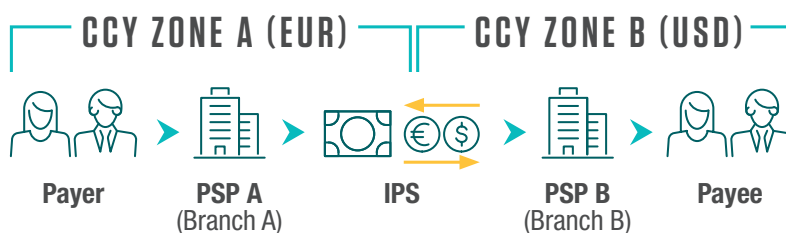
The Nexus project, driven by BIS, will link the instant payments systems of Thailand, Indonesia, Malaysia, Singapore and Philippines.⁵

IXB Project

The IXB initiative is a joint project of The Clearing House, EBA Clearing and Swift. It aims to connect two instant payment systems – RTP in USD and RT1 in EUR – across the Atlantic, to facilitate and support payments in one of the world's largest financial corridors.⁶

Over 25 financial institutions are involved in this initiative, which highlights the immense potential of IXB. A similar principle has already been proven in Asia with the PromptPay-PayNow connection in Thailand and Singapore and the UPI-PayNow linkage in India and Singapore.^{7,8}

Cross-border payment with closed-loop model



Closed-loop model

In the closed-loop model, the payment service providers of the payer and the payee are one and the same entity or part of the same organization, often a multinational financial institution operating in different currency zones with a single instant payment system. This model is advantageous due to

its simplicity, as it involves fewer entities, does not require correspondent arrangements and pre-funding, and ensures fast transactions. However, it also carries risks, such as a potential lack of regulatory oversight, market inefficiencies due to a lack of interoperability, and market dominance by a few closed systems.

THE IMPACT ON GLOBAL COMMERCE

Empowering small and medium enterprises (SMEs)

SMEs often face significant challenges when entering the international market, primarily due to the complexity and cost of cross-border transactions. Instant payments level the playing field, enabling these businesses to compete globally with larger corporations.

Enhancing trade relations

Faster payments mean quicker settlement of accounts, which in turn fosters trust and stronger business relationships. This

efficiency can lead to an increase in trade volume, benefiting economies around the world.

Supporting economic inclusion

Instant cross-border payments play a crucial role in financial inclusion. By providing affordable and accessible financial services, they empower individuals in developing regions, allowing them to participate more fully in the global economy.

CHALLENGES AND FUTURE OUTLOOK

Instant cross-border payments are revolutionizing the way we transfer money globally, but their implementation comes with a host of challenges.

Addressing these issues is vital for ensuring the efficiency, security, and accessibility of payment systems. Here are some of the primary challenges:

Regulatory and compliance issues

- **Regulatory variations:** Countries have varying regulations governing financial transactions. Harmonizing these regulations to facilitate instant payments is complex and time-consuming.

- **Anti-Money Laundering (AML) and Know Your Customer (KYC):** Ensuring compliance with AML and KYC regulations across multiple jurisdictions is a significant challenge. Financial institutions must implement robust verification processes without compromising the speed of transactions.

Currency exchange and conversion

- **Fluctuating exchange rates:** Managing currency conversion in real-time can be difficult due to constantly changing exchange rates. This can affect the cost and timing of transactions.

- **Conversion fees:** Even with instant payments, conversion fees can be high, especially for less common currency pairs.

Technical infrastructure

- **Interoperability:** Achieving seamless integration between different financial systems and networks is critical. Ensuring that different payment platforms and banking systems can communicate and work together efficiently is a major technical hurdle.
- **Network reliability:** Ensuring consistent, reliable connectivity and avoiding downtime is essential for maintaining the integrity of instant payment systems.

Security and fraud prevention

- **Cybersecurity threats:** As with any digital financial service, instant cross-border payments are susceptible to cyberattacks. Implementing robust security measures to protect against fraud, hacking, and data breaches is crucial.
- **Fraud detection:** Real-time transactions make it harder to detect and prevent fraudulent activities. Financial institutions must deploy advanced analytics and AI-driven tools to monitor and identify suspicious behaviour.

Operational and processing costs

- **Transaction fees:** While instant payments can reduce costs in some areas, there can still be significant transaction fees, especially when multiple intermediaries are involved.
- **Infrastructure investment:** Developing and maintaining the technology infrastructure required for instant cross-border payments involves substantial investment.

User experience and trust

- **User adoption:** Convincing individuals and businesses to switch to new instant payment systems requires building trust and demonstrating reliability.
- **Education and support:** Providing adequate education and customer support to help users understand and effectively use new payment systems is essential for widespread adoption.

Data privacy and protection

- **Cross-border data transfers:** Countries have different data protection laws, and transfers of personal and financial data across borders must comply with these regulations to protect user privacy.
- **GDPR and other data regulations:** Compliance with regulations such as the General Data Protection Regulation (GDPR) in the European Union adds another layer of complexity.

Economic and political factors

- **Political instability:** In some regions, political instability can affect the reliability and security of financial transactions.
- **Economic policies:** Exchange controls and economic policies in different countries can impact the feasibility and cost of cross-border payments.

CONCLUSION

Despite challenges, instant cross-border payments are driving innovation and investment, as evidenced by increasing venture capital investments in fintech companies and the adoption of blockchain and digital currencies.

Regulatory bodies and governments are increasingly recognizing the need for improved cross-border payment systems and supporting initiatives that drive innovation in this space. For instance, the G20 has identified enhancing cross-border payments as a priority, leading to the Financial Stability

Board (FSB) and other international organizations developing a roadmap for improvements.⁹

Making progress in this space requires a coordinated effort among financial institutions, regulatory bodies, technology providers, and governments. As solutions continue to evolve, the vision of seamless, instant cross-border payments is becoming increasingly attainable, promising a more connected and efficient global economy and trade.

HOW CAPCO CAN HELP

Capco can guide financial institutions through the adoption of instant payments. We leverage our global expertise to help clients navigate the journey, addressing challenges that arise and aligning their strategies to future-proof their business.

Capco's role extends to advising on and fostering innovation in financial services, including in instant payments. We help institutions improve financial inclusion, minimize transaction costs, and enhance data privacy. On the regulatory front, we support our clients in establishing robust anti-financial crime measures, ensuring transparency, and optimizing operational controls and procedures.

As a global player, Capco offers a wealth of technical and regulatory knowledge and a team of SMEs experienced in implementing instant payments schemes across the SEPA area, UK, USA, APAC, etc. We can support connecting your payments business to a variety of instant payment schemes and interlinking different instant payment systems.

Contact us to discuss and find out more.

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ABOUT CAPCO

Capco, a Wipro company, is a global management and technology consultancy specializing in driving transformation in the energy and financial services industries. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

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