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Cross Border Payments: Real Time vs Fraud

Discussion Note and Outcomes from P20 Dinner - January 10, 2024

The exponential growth of Real Time Payments (RTP) in domestic markets is driving expectation and demand for similar timeframes in cross border payments.

In November 2022, P20 produced a thought leadership report, Towards Borderless Payments: Best Practice Recommendations which highlighted the key challenge:

> *Harmonizing cross border rules and regulations on interoperability, efficiency and cost while ensuring that there is a continuing decrease in fraud and money laundering is the major issue that needs to be solved.*

The discussion's principal focus was on RTP and the effect that the speed of a transaction has on the risk of fraud and assisting money laundering.

Other linked areas considered were:

- Fraud education by remitting entities has undoubtedly improved customer awareness in domestic payments, and checks on the receiving entity are strong (e.g. UK Confirmation of Payee). Cross border checks between US and UK are good but to less regulated countries is not available. Should RTP only be open to countries and banks that pass the test of strong ID verification, KYC and enable the remitter to have confirmation of the bank details of the receiver before money is sent?
- A RTP inherently carries more risk. Should cross border payments be like international mail where there is multiple choice as to speed and security of delivery, eg. tracking, signed receipts, insurance etc. but at higher price to the remitter?
- The financial rewards from providing cross border payments are considerable. The race between existing players and new entrants, often with new business models, enable criminals to seek the weakest links in the chain. Regulators are inevitably behind the curve on identifying cross border new entrants that may cause systemic risk.
- SWIFT is restricted by the time it takes for transactions to settle, which can take several days in many jurisdictions, resulting in delays and additional costs for both senders and recipients. Is it time to look more closely at blockchain solutions to overcome this issue?

Discussion

From the outset, there was a recognition that progress can only be made through **collaboration**. No one entity – whether industry or regulator – can achieve a solution. For an idea as to what collaboration can achieve, the example of the Nordics was given.

The heart of the problem is that there is a **lack of a rulebook with standards** agreed by governments and industry players. And the regulation that is implemented needs to trend towards delivering outcomes. But there is a view that **technology can solve these challenges** and will likely be more timely than regulation. In creating regulation, it is important to consider **financial inclusion** as a factor and ensure that solutions are equitable because on the retail side, some of the most prolific users are unbanked or under-banked.

Harmonization has been a goal in the last few years but there is a recognition that it has been slow progress to achieve any substantive change. Some jurisdictions are now seeking to **adopt models already in use** with small changes to customize the model to local factors.

The **lack of interoperability** in cross border payments has led to the linking of domestic RTP systems. This is progress but as has been seen, particularly in the UK, APP fraud has skyrocketed due to RTP, necessitating a regulatory change which focuses on sharing liability between remitting and receiving FIs to encourage a behavior change to strengthen KYC at the time of account opening. But the use case for every cross border payment to be real time has not been made.

The discussion naturally turned to the sharing of data to validate that both the remitter and receiver are bona fide. The dichotomy of sharing identifiable customer data and the implications to GDPR have caused reluctance for the industry to move forward.

The present huge differences in regulatory supervision throughout the world make it impossible to have uniform RTP on the same terms and conditions. Strides to harmonize regulation are underway and certain payment corridors US to UK to US are already open to overnight payment and settlement.

While CBDCs may have a role to play, they will not become mainstream for cross border payments in the medium term. Stablecoin issued by AAA banks (eg. JPM Coin) will grow strongly, especially as other banks may participate in coalitions under just a few schemes. However, in the near term, their use will be predominantly wholesale.

Closing Outcome

The discussion concluded by considering how improvements to fraud detection can be achieved by using AI/ML models analyzing historical anonymized payment data sets. The opportunity to use six months of anonymized payment data, making up, say 50%, of all payments, and running these transactions through models, already trained to identify potential fraud, would enable a measurement of this figure against the actual fraud captured by FIs.

The New York Department of Financial Services (NYDFS) is establishing a Data Governance Unit to assess what data sets are relevant for improving KYC. NYDFS wishes to work with the payments ecosystem, including P20 members, to scope this and an opportunity exists to create a pilot to identify the key data sets for combating fraud. This would be an extension of the US/UK PETs Challenge (Privacy Enhancing Technologies).

It is estimated that utilizing such models trained on anonymized payment data to identify probable fraud would give a 30+% reduction in fraud detection against current practice.