Asian Banker Research

Deutsche Bank

White Paper

How are Asian FIs meeting the challenges and opportunities of cross-border payments?

A Survey on Trends in Cross-Border Payments in Asia Pacific

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Foreword

The provision of cross-border payments is a key challenge faced by many financial institutions in the region. Growing intra and inter region trade and investment flows between Asia and other parts of the world have created added demand for financial institutions to provide timely, accurate and cost effective cross-border payment solutions to their customers. Cross border payments are still mostly effected through wire-transfers via traditional networks of correspondent banking relationships. Today's cross border payments landscape continues to be dominated by such arrangements between institutions that operates in countries that have different legal and regulatory requirements which result in inefficiencies and additional costs for users.

International banks that operate in multiple locations and are connected to the local clearing networks in the region have created their own intra-organisation cross-border payment capabilities and stand at a distinct advantage to provide integrated payments, treasury and cash management services to FIs and corporates in Asia. However, the concentration of cross-border payments amongst the major banks pose potential liquidity and settlement risks in times of crisis.

Global payments volumes are forecasted to grow 9% annually through to 2020 and the flow is shifting to Asia. According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), top 80 payments banks have reduced their nostro relationships in Europe, the Middle East, Africa and Americas while they have increased in Asia. Non-cash transactions in emerging Asia have been growing at more than 20% annually since 2007 whereas in developed Asia, growth ranges from 3% to 11% annually.

This white paper is based on a survey of a sample of practitioners in Asia Pacific on how they view developments in cross-border payments as well as the challenges that they face. This paper aims to show how strategic correspondent banking alliances can help alleviate the challenges emerging in developing countries in Asia.

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1. Introduction

Asian Banker Research conducted a survey of leading financial institutions (FIs) in Asia Pacific to identify macro trends that are driving cross-border payments requirements and how FIs are changing their payments infrastructure to not only adapt to this new environment but also grow/expand their payments and overall transaction banking business.

We focus on the geographical locations where FIs are observing growth in cross-border payments flows, for example between ASEAN and other Asian markets, and identify the challenges and issues posed by the different legal and regulatory environments as well as changing global regulations.

We explored the growth strategy of FIs within and outside of Asia, and their focus on different customer segments, for example; institutional, corporates, retail, MNCs, SMEs and across geographies.

The survey was conducted through a number of dialogues with senior transaction banking executives across banks in Asia to assess their views on cross-border payments within the region. This consultation paper represents the outlook portrayed by the practitioners. We sought to provide a broad range of views of FIs and banks in the region.

Senior transaction banking executives with whom we conversed include:

- Azrol Faizal B. Ahmad Padzli – Global Head Financial Institutions & Non-Bank Financial Institutions, Transaction Banking, Global Banking (Maybank, Malaysia)
- Bill Chua – Managing Director, Head, Global Financial Institutions Group (United Overseas Bank, Singapore)
- Ferry Robbani – Senior Vice President, Head, Financial Institutions Coverage & Solutions (Bank Mandiri, Indonesia)
- Gary B. Villanueva – Executive Vice President, Group Head, Global Transaction Banking Group (Rizal Commercial Banking Corporation, the Philippines)
- Howard Chui – Regional Head of Financial Institutions, Asia (National Australia Bank, Hong Kong)
- Jun Cervantes – First Vice President, Head of Operations (Unionbank of the Philippines, the Philippines)
- Kazuo Kitada – Deputy General Manager, International Business (The Osaka City Shinkin Bank, Japan)
- P.B. Prakash – Head, Global Financial Institutions (Axis Bank, India)
- Samuel So – Head, Cash Management (Bank of China (HK), Hong Kong)
- Shin Dong Hoon – Executive Vice President, Global Products and Services Division (Korean Exchange Bank, Korea)
- Sun Meiyu – General Manager, International Department (Agricultural Bank of China, China)
- Wu Bin – General Manager, International Banking Business (Industrial and Commercial Bank of China, China)

Topics discussed with the Asian banks include the macro trends observed, challenges faced in dealing with disparate regulatory environments in the region, evolving customers' needs, infrastructure that banks own and are investing in and working with international partners.

The views of participants on the various aspects of cross-border payments can be summarised as follows:

1. Growth in trade and investment flows between Asia and other parts of the world is driving demand for cross-border payments. FIs and corporates are seeking more cost-effective and timely cross-border payments options, especially for Asia bound payments. They are also seeking the ability to make and receive payments in a greater variety of currencies.

2. New regulation and compliance requirements for intra-day liquidity management are driving demand for improved and integrated information flow on cross-border payments. Current payments infrastructures do not support the more complex and holistic requirements of new regulations, such as Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR).

3. The payments landscape is very competitive and international clearing banks are providing domestic banks with local support, integrated packages covering cash management, treasury and trade solutions, multicurrency capability and quality service with competitive pricing.

4. There's a growing demand for cost effective payments solutions over traditional wire-transfer and correspondent banking based solutions to improve cross-border payments.

5. Compliance and operational risk requirement arising from Anti-Money Laundering (AML) and Know Your Client (KYC) rules are driving banks to evaluate their relationships with correspondent banks, having to strike a balance in the number of banks they partner with as well as reporting requirements.

6. Although some domestic banks are lacking in areas such as cross-border clearing and settlement , most internationally-focused banks in developed and emerging markets have the appropriate systems in place. To establish efficient payment and collection processes in these target countries, a common strategy is to have a large correspondent banking network.

7. Banks continue to revamp their payments infrastructure to strengthen the system capacity to support the high transaction volumes for the next 10 to 20 years. The enhanced systems are also intended to provide multi-currency support, assist with high level of reporting requirement and ISO/SWIFT file formats available as well as the ability to provide STP connectivity to enterprises via host-to-host facility to enhance overall operational efficiency.

8. The payments business is becoming increasingly competitive, leading to narrowing margins. Banks are thus looking to increase operational efficiency for more seamless transactions through higher levels of automation and STP.

9. Competition does not only occur among banks. Non-bank payment service providers such as PayPal, Western Union, Telco companies and the international card associations, are posing fierce competition as they can accept a range of payment methods and have the ability to connect to multiple banks as well as proprietary international payment networks. Even, payment messaging service provider, SWIFT, has introduced direct Corporates to Banks connectivity, enabling corporates to send payment messages directly to receiving banks.

10. The renminbi is becoming more widely used for payments and settlements, and FIs are enhancing their ability in the payment and collection of the currency, as well as provide a full range of treasury products to deepen the use of the currency.

2. Challenges faced by Asian Financial Institutions

- Smaller banks find it hard to provide a holistic set of outbound payment solutions and work with large international payment banks such as Deutsche Bank, HSBC and Citibank. Unsurprisingly, services provided by smaller banks are generally more limited relative to international banks.

- With more players providing numerous basic features, the payment business is becoming extremely commoditised. Customers have more options and the pricing structures as well as the provision of fast and accurate services are key success factors.

- While the larger banks are already equipped for scale and volume,some banks are still evaluating their payment businesses to ensure volumes and margins can justify the investment on system upgrades. However, banks arealso acknowledging that technology alone provides no sustainable competitive advantage and the differentiator lies in building and managing client relationships holistically.

- New and more stringent regulatory requirements are having a significant affect on banks' payment processes and operations. For example, banks have to implement tighter filters in the payment systems to meet more stringent Know Your Customer (KYC) and Anti-Money Laundering (AML) criteria. New LCR and NSFR liquidity risk management requirements are causing banks to revie their current payments systems' ability to support additional monitoring and reporting requirements.

- Due to stricter regulations, correspondent banks are evaluating client banks to ensure they adhere to compliance guidelines. Banks have also had to reevaluate long-term relationships with counterparty banks or corporate clients which compliance departments deemed to be too risky.

- Most banks are selecting one or two global currency clearing financial institution partners to support their cross-border payments needs, instead of using different providers for different currencies. This facilitates easier and simpler monitoring of counterparties given the stringent regulatory environment. However, FIs do balance the need to simplify their payments solutions with not concentrating their liquidity and settlement risk exposures to only a few major banks.

3. Evolving customer requirements

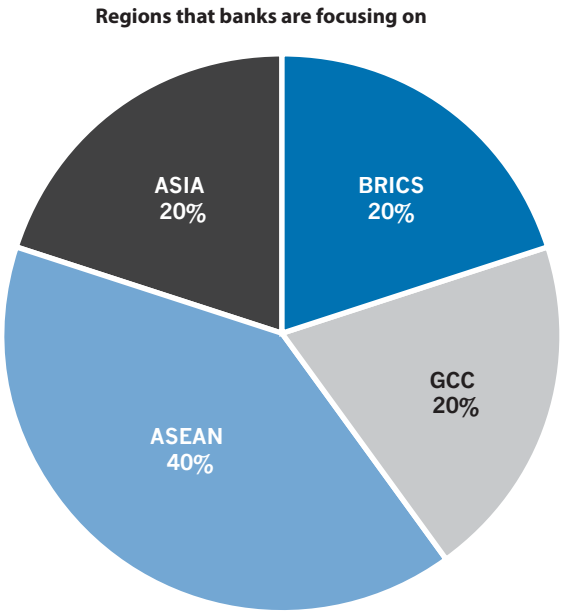
- Corporates in developing countries have difficulty embracing electronic payments as they prefer physical paper transactions. Shifting to paperless payments would require them to undergo a shift in their business model.

- Emerging market banks are still developing their capability to handle cross-border payments. In addition, lack lustre adoption of industry standards is hampering business-to-business (B2B) payments and innovation. There needs to be more education and incentive to encourage corporates to adopt greater level of automation and common standards.

- Large corporates have a greater need for customized and integrated solutions and are more likely to negotiate pricing. Smaller FIs, unlike their international FI partners, do not have the expertise or scale to provide such services in a cost effective and operationally efficient manner.

- The challenge for small and medium enterprises (SMEs) lies in their lower volume and liability base. The strategy for SMEs is to provide standardised solutions and integrate their working capital needs on an end-to-end basis.

Figure 1.1. **ASEAN is the main focus among transaction banks**



Source: Asian Banker Research

- The ASEAN region constitutes the largest client segment which surveyed banks are focusing on. More specifically, the top three countries cited are China, Indonesia and Japan – making up 21% each. This is followed by Korea (14%) and India and Russia (7% each).

- Apart from the countries in the aforementioned regions, a couple of banks stated the US and Europe as their focal areas.

- To establish efficient payment and collection processes in these target countries, a common strategy is to have a network of banks who can provide clearing services and have RMA swift key exchanges.

- There is also a widespread emphasis on investing in the payment platform for certain banks as customers are moving away from paper input, and are automating and digitizing their payment transactions.

- In order to make processes more time and cost efficient, some banks are implementing bilateral interbank settlement arrangements for US payments to be settled close to real time.

- A few banks have centralized their payment infrastructure and provide client servicing through regional customer service offices in the countries in which they operate. The challenges for these banks include maintaining turnaround times and supporting client enquiries.

- The delivery of detailed real-time (reporting is generally next business day or hours after each payment batch) reporting for corporates and FIs is also crucial to effectively help manage their liquidity.

- Larger corporates are requesting straight-through processing (STP) with minimal manual intervention for their bulk transactions and an integrated package that can better manage capital flows across the region instead of on a country-by-country basis. These integrated packages involve lending, long-term funding and payments.

- Banks currently support the major currencies that clients need and are prepared for requests in more exotic currencies. For example, they are currently developing their renminbi capabilities and exploring partnerships with China and Hong Kong-based banks.

- Banks that provide highly customized and integrated products and solutions and provide country or industry specific insights and advisory services are able to compete more effectively. While pricing is under pressure, banks do have an advantage if they are able to meet clients' requirements for better service, higher operational turnaround and efficiency as well as a wide network across the region.

- Service quality is a key success factor. Banks are investing in customer services, such as extending the cut-off time for certain currency payments. This includes a high level of customer service that ensures client queries are dealt with and resolved in a timely manner.

- In recent years, there has been an increase in intraday liquidity management demands from financial institutions, with the prime objective of ensuring timely processing of cross-border payments.

4. Payments infrastructure banks are building and investing in

- Technology is enabling greater capacity for online and real-time payments processing. Such features allow business transactions regardless of the time and place and funds can be optimised through on-time payments and collections.

- Some banks employ payment specialists to support client enquires. Payment specialists are located in close proximity to their customers so that they can operate on the same time zone as their customers.

- Although traditional correspondent banking networks exist to provide cross-border payments services, cross-border and multi-currency payments systems in ASEAN are being continuously developed and improved to support the growth in scale and scope of large value payments and investment transactions that would originate from increasingly integrated capital and financial markets.

- As payments transactions have tripled in the past decade, banks are revamping their infrastructure to strengthen system capacity and support transaction volumes for the next 10 to 20 years. The enhanced systems are also intended to provide multi-currency support, customisable reports and ISO/SWIFT file formats and deploy an enterprise host-to-host facility that can reduce operational time.

- Banks are also preparing to replace applicant and beneficiary data to support their STP format and reduce turnaround time. More ambitious banks are extending cut-off time for trade settlements.

- Integrating FX and clearing capabilities of some correspondent banking partners allows banks to seamlessly offer additional currencies through client-facing channels. This white labelling approach has allowed banks to offer currencies to customers without having to establish stand-alone clearing arrangements and to take on additional currency risk.

- At the same time, ensuring the security of these payments is crucial. A few banks are investing in the Secure File Transfer Protocol (SFTP) process. These capabilities provide significant improvements in terms of the speed of transaction, greater network coverage and ease of domestic funds transfer.

- To provide a seamless and integrated experience to customers across markets, banks are dedicating investments on core banking platforms on the back-end and a regional payments platform for the front-end. Interfaces are redesigned and the speed and quality of service are improved with a standardised core banking system.

5. Working with international banking partners

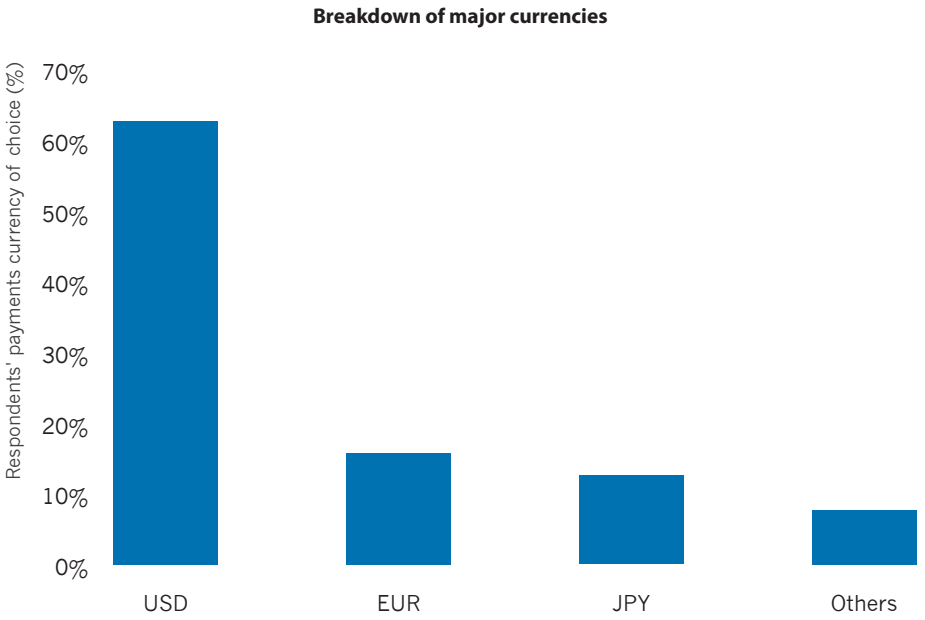
- In circumstances where banks are not direct members of clearing houses, they work with main correspondent banks to process payments. For currencies with high volume, such as the US$, banks often engage up to six US$ clearing providers.

- As costs increase, banks are rationalising the number of correspondent banking relationships across regions. Furthermore, in order to meet customers' needs and expectations, bank alliances are being formed. In some cases, correspondent banking relationships are established ona short-term basis, created for a particular time period and for a specific product. Some banks are also moving away from wire-transfer based correspondent banking arrangement to partner with international banks to leverage their ACH solutions in the region.

- The consolidation is further driven by compliance. Banks are in search for trusted partners to provide clearing services in different parts of the world. In the past, banks used to have correspondent banking accounts with many banks. But due to settlement risks and compliance requirements, banks have had to rationalise their correspondent banking relationships

- FIs are seeking international banks that have multi-currency capabilities for ease of regulatory compliance and costs efficiency – for instance, engaging an international bank multi-currency settlement, such as US$ and euro payments. Banks interviewed find it easier to work with a partner bank that can offer services in multiple currencies than to work with multiple correspondent banks for different currency combinations.

Figure 1.2. **US$ remains the top payments currency**



Source: Asian Banker Research

- Several factors are taken into consideration when choosing a correspondent bank. One fundamental factor is the local support these banks provide. It is preferable to have a local team working in the same time zone and speaking the same language to shorten response time.

- US$ continues to be the main currency for payments and trade transactions.

- Second and third major currencies differ across the region. They are mostly the euro and Japanese yen, though usage varies. The home currencies of banks also naturally contribute significant volume.

- Although there has been growing interest in and requests for payments and collections in Rmb, the volume has not picked up too significantly. To take advantage of the internationalisation of the Rmb, FIs are establishing correspondent arrangements with key Chinese banks to facilitate efficient settlement of these transactions while expanding their own operations in China.

- As trade and businesses are increasingly diversified across countries, payments will be less concentrated in the US$ and euro. One notable innovation that banks brought up involves the multi-currency payments capability products that international banks offer. Many banks already have the capability to conduct cross-border payments, but the ability to clear as many as 125 currencies is only accomplished by a few, such as Deutsche Bank.

- Many financial institutions are looking to partner with truly global banks as business becomes more global and cross-border activity increases. And although the US dollar and euro are still the world's leading currencies, other, such as the RMB, are growing in importance. One notable innovation is the multi-currency payment capability products that international banks are now offering. Many banks already have the capability to conduct cross-border payments, but very few have the genuine global perspective and network that Deutsche Bank offers, which enables the Bank to clear as many as 125 different currencies. This is an important element in Deutsche Bank's commitment to financial institutions in the region and underlines our position as a capable and sustainable partner for cross-border payments.

6. Conclusion

- Cross-border trade and investment are expected to increase and banks are seizing the opportunities by enhancing their cross-border payment infrastructure and solutions.

- Financial Institutional clients are demanding that their correspondent banking partners can offer holistic global clearing services.

- Payments regulations and standards in Asia vary from country to country. This constitutes a big challenge to cross-border payments services. Standardisation and harmonisation of payments standards in the region will ensure greater interoperability that will lead to improved operational and cost efficiencies.

- To satisfy client's needs, banks should help "regionalise" enterprises to manage their supply chain and payments requirements across a wider range of time zones and currencies. Essentially, banks need to provide value-added services to win against the competition in future cross-border payments business.

- It is important to get compliance and operational risk management right. Failure to fulfil AML and KYC requirements may result in severe penalties and reputational damage. The gaps in banks' ability to meet new complex regulatory requirements will create opportunities for banks to differentiate themselves. Strong relationships with partner banks that have capabilities in the same region are fundamental to providing clients with reliable support and service.

- There is an increasing focus on the Rmb. More product innovation and developments in the onshore and offshore markets can be expected.

This survey was completed with the support of:

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