Financial Services Briefings

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Cross-Border Payments and Settlements

Global cross-border payments, both retail and corporate, are growing at a steady pace. Nonetheless, these transactions remain expensive, compared to domestic payments. There is also a lack of transparency in the process.

A fundamental paradigm shift may be required to address these issues, over the longer term, enabled by new technology platforms.

To that end, two reports released by the Monetary Authority of Singapore, cast light on the current developments. These reports explore the root causes of existing challenges, the desired future-state capabilities and the potential operating models.

I trust that this issue will provide you with an overview of the topics, and insight to help you navigate the future landscape of cross-border payments.

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Cross-Border Payments and Settlements: Emerging Opportunities for Digital Transformation

By Chia Tek Yew

The value of retail and corporate cross-border payments is set to grow at a rapid pace in the coming years, bolstered by rising consumption, changing economic trends and international commerce. However, cross-border payments remain expensive when compared with domestic payments, and the lack of transparency is a concern.

Taking a lead in driving thinking, collaboration and solutions in cross-border payments and settlements, the Monetary Authority of Singapore (MAS) released two reports at the annual Singapore Fintech Festival last November – **Cross-Border Interbank Payments and Settlements**[1], and **Cross-Border Payments Interoperability Network (XBPIN) Feasibility Study**[2].

The reports present current and evolving thinking and intentions around central payment infrastructures. There is discussion of the collaborative efforts between policy-makers and the industry to innovate, address cross-border payment challenges, and to promote financial integration and inclusion. These insights will help you visualise how these intentions and efforts may evolve and take shape, and the opportunities that await.

Cross-Border Interbank Payments and Settlements

This report is a cross-jurisdictional industry collaboration between Canada, Singapore and the United Kingdom. This project was initiated by the Bank of Canada (BOC), the Bank of England (BOE) and the Monetary Authority of Singapore (MAS), and includes contributions from subject matter experts from several commercial banks led by HSBC. Other commercial banks in the group include Oversea-Chinese Banking Corporation (OCBC), Toronto-Dominion Bank (TD) and United Overseas Bank (UOB).

Over a three-day workshop facilitated by KPMG at its U-Collaborate facilities in London, UK, the participants assessed existing challenges that arise when undertaking cross-border payments and the explored possible newer options for processing cross-border transactions.

Key challenges identified

- Cross-border payment end users lack clarity on the time required to complete cross-border payments, the applicable fees, and have no visibility of payment transaction status.

- Commercial banks have no visibility of transaction processing status and must manually process cross-border transactions given the dependency on the correspondent banking model. Often this involves multiple banks and the process locks up signi icant liquidity. Additionally, with differing payment settlement infrastructures across countries and the lack of common payment messaging standards, straight-through processing capabilities are hindered and the cost of end-to-end payment processing for banks remain high.

- Central banks provide the domestic real-time gross settlement (RTGS) systems which are essential for the processing of cross-border payments but these were developed with differing membership requirements, standards and technical specifications. As a result, smaller banks are challenged to join multiple RTGS systems, thus increasing the need for the number of intermediaries required to complete a cross-border payment.

Industry initiatives to address these challenges include domestic RTGS system enhancements, cross-country ISO20022 messaging standards implementation, continuous linked settlement developments, SWIFTgpi in relation to payment speed and visibility, and centralised customer due diligence utilities. However, there needs to be a paradigm shift to address these challenges in a more holistic way, perhaps enabled by new technology platforms in the longer term.

Desired future-state capabilities

The future-state capabilities expected of a cross-border payment system model that addresses identified challenges and

Sources:
1. Bank of Canada; Bank of England; Monetary Authority of Singapore. (2018) Cross-Border Interbank Payments and Settlements: Emerging opportunities for digital transformation. Retrieved from http://www.mas. gov.sg/News-and-Publications/Media-Releases/2018/Assessment-on-emerging-opportunities-for-digital- transformation-in-cross-border-payments.aspx
2. KPMG in Singapore. (2018) Cross-border Payment Interoperability Network Feasibility Study. Retrieved from https://home.kpmg/sg/en/home/insights/2018/11/xbpin-feasibility-study.html

resolve underlying root causes are:

- **extended processing availability** of domestic and international payment systems.
- **visibility** of payment status and **certainty of outcome** for more efficient management of liquidity and cash flow.
- **direct, peer-to-peer payment** and settlement (synchronised Payment versus Payment) between originating and beneficiary banks to reduce end-to-end processing costs.
- **consistent payment standards and greater transparency** of regulatory differences and regulatory requirements across jurisdictions.
- **enhanced technical infrastructure** of payment systems that reinforce and increase stability and resilience, and promote wider access and innovation.

Potential future-state models

Three hypothetical models were developed, and the relative merits and challenges were then analysed.

Two of the models are based on an enhancement of existing domestic interbank payment systems using current technology, with no change or modification to the existing underlying correspondent banking model. These two models could meet some, but not all, of the future-state capabilities.

The third model has three variations and is based on the concept of central banks issuing a wholesale central bank digital currency (W-CBDC). The issuance and exchange of these W-CBDCs between banks would be done through a distributed ledger technology (DLT)-enabled platform built to facilitate cross-border payments. This model supports features such as 24-7 availability and payment tracking in the central infrastructure.

What is important to note is that regardless of model, the scale of the technical challenge to implement each of the three models cannot be underestimated.

Policy makers and service providers will need to conduct further research to evaluate which of the three models could deliver far-reaching benefits. They will also need to assess the policy implications associated with each model and around partnering with the private sectors to further innovation.

Cross-Border Payments Interoperability Network Feasibility Study

This study, commissioned by MAS, the Association of Banks in Singapore (ABS) and the Thai Bankers' Association (TBA), was conducted by KPMG. It comprised a survey, research, discussions and interviews with stakeholder representatives from several regional banks and network operators across ASEAN. The ensuing report captured the key tenets of payment interoperability vision and scheme, rules of engagement by operator(s) and participants, benefits gained and the recommended standards to enable effective operations of an interoperable model.

KPMG's analysis of the findings suggest that a pan-ASEAN regional payments rail is feasible and economically viable, and the business case would improve as more countries, players and consumers adopt it.

A regional payment network will bring ASEAN a step closer to realising the ASEAN Economic Community 2025 vision of financial integration, reduced operating costs for payment incumbents, increased revenues, and help onboard more underbanked and unbanked customers. But for this to work, real-time payments must be available domestically, and adoption of internationally accepted payment standards will be necessary to facilitate ease of global integration within and beyond ASEAN.

Regulatory, Tax and Technology Updates

Regulatory Updates

Commercial Banks

E-payments User Protection Guidelines

The MAS first issued the e-payment user protection guidelines in September 2018, scheduled to come into effect on 31 January 2019. Subsequently, on 31 January 2019, MAS announced it will delay the implementation of the guidelines to 30 June 2019.

These guidelines set out expectations of any responsible financial institution (FI) that issues or operates a protected account, and sets out the duties of users of protected accounts. The aim of these guidelines is to establish a common baseline protection offered by responsible FIs, on a business as usual basis, to individuals or sole proprietors. The guidelines aim to protect them from losses arising from isolated unauthorised transactions or erroneous transactions. Duties of accounts holders include:

- providing contact information and monitoring of notifications.
- protecting access codes and access to protected accounts.
- reporting unauthorised transactions.

Duties of responsible FIs include:

- informing account holders of user protection duties.
- providing transaction notifications
- providing recipient credential information.

Securities, Futures and Fund Management

Securities and Futures (Classes of Investors) Regulations 2018

To enhance regulatory safeguards for investors, the MAS released a new Securities and Futures (Classes of Investors) Regulations on 8 October 2018. This release supersedes the Securities and Futures (Prescribed Specific Classes of Investors) Regulations.

The new regulations cover the following:

(a) updated definitions of accredited investor and institutional investor (effective 8 October 2018).

(b) requirement for FIs to provide a written statement to existing customers to continue treating them as accredited investors and to include the option to opt out by 7 April 2019.

(c) requirement for FIs to obtain explicit opt-in from customers to be treated as accredited investors. This applies to customers onboarded from 8 April 2019. For avoidance of doubt, customers who have opted in may opt out.

Securities and Futures (Licensing and Conduct of Business) Regulations (SF(LCB)R)

On 8 October 2018, the MAS issued the revised SF(LCB)R that includes the following key amendments:

(a) Customer's Moneys and Assets The MAS has now imposed the following new requirements:

i. FIs to perform due diligence on specified FI and third party custodians prior to opening a trust or custody account as well as on an ongoing basis.

ii. FIs to obtain acknowledgement from overseas custodians prior to depositing the customer's moneys in an overseas trust account.

(b) Computation for Trust Accounts and Custody Accounts
The MAS extended the computation of trust accounts and custody accounts to all Capital Market Intermediaries (CMI) holding customers' moneys and assets.

(c) General Risk Disclosure Requirements
These requirements are applicable only to CMIs dealing in specified capital markets products (i.e. other than futures contracts, spot foreign exchange contracts for the purposes of leveraged foreign exchange trading and FX OTC derivatives contracts) on behalf of the customer who is not an accredited investor, expert investor, institutional investor or related corporation of the CMI.

i. MAS now requires such CMIs to provide a written risk disclosure document to the customer and to ensure the customer acknowledges in writing the receipt and understanding of the risk disclosure document. This must be done prior to such CMIs opening a trading account for the customer to trade in specified capital markets products.

ii. Subsequently, prior to entering any transaction of sale or purchase of any specified capital markets products for the customer, such CMIs are required to disclose to the customer whether they are acting as a principal or an agent for the customer's transaction(s).

Notice on Minimum Entry and Examination Requirements for Representatives of Holders of Capital Markets Services Licence and Exempt Financial Institution (SFA04-N09)
On 5 October 2018, MAS revised Notice SFA04-N09, which prescribes minimum continuing professional development (CPD) hours, with the revision coming into effect on 1 January 2019. Appointed representatives under the Securities and Futures Act (SFA) must complete six hours of core CPD hours in ethics or rules and regulations, or both (which are accredited by IBF), and three

supplementary CPD hours of relevant training courses by the end of every calendar year. Representatives who are appointed for less than a calendar year will be required to complete a pro-rated minimum number of core and supplementary CPD hours.

Exemption

The minimum CPD hour requirements will not apply to:

(a) an individual who is an appointed representative of any Capital Markets Services licence holder or exempt FI for the first time. This is for the period starting on or from the date of first appointment as an appointed representative and ending on the last day of the same calendar year.

(b) appointed representatives who serve only accredited investors and/or institutional investors.

Notice on Risk Factsheet for Contracts for Differences (SFA04-N15)

With effect from 8 October 2018, FIs dealing in contracts for differences (CFDs) for, or on behalf of, retail customers are required to:

(a) provide a risk fact sheet in accordance with the format set out in the Annex to MAS Notice SFA04-N15 to the following parties:

i. new retail customers – prior to opening a trading account for the customer to transact in CFDs.

ii. existing retail customers – before the customer transacts in the CFDs using the trading account for the first time on or after a specified date.

(b) ensure the customer provides a written confirmation to acknowledge receipt and understanding of the risk fact sheet.

Further guidance notes can be found in the Guidelines to MAS Notice on Risk Fact Sheet for CFDs.

Consultation Paper

Consultation paper on Proposed Revisions to the Exemption Framework for Cross-Border Business Arrangements of Capital Markets Intermediaries

Currently, under the SFA and the Financial Advisers Act, foreign persons who conduct regulated activity partly in and partly outside of Singapore are required to be licensed or exempted. An exemption framework is available for business arrangements between FIs in Singapore and their foreign related corporations (FRC Framework) upon application to the MAS on a case-by-case basis.

In December 2018, the MAS proposed to streamline the FRC Framework, by replacing the case-by-case approval with an ex-post notification to the MAS of these arrangements. Under the proposed framework, FIs in Singapore and their foreign related corporations (FRC) may commence the conduct of regulated activities and will only be required to notify the MAS within 14 days of commencement of every such arrangement, and confirm to the MAS on its compliance with the boundary conditions. The boundary conditions will be similar to existing conditions that the MAS currently imposes and include:

- Singapore entities must have the relevant licence or authorisation to conduct the corresponding regulated activities.
- FRCs and its representatives to be licensed or authorised in their own jurisdiction in respect of the regulated activities under the business arrangement.
- Arrangements are restricted to dealing with non-retail customers.
- Singapore entities are required to have in place policies and procedures to oversee the conduct of the FRC and its representatives.
- Singapore entities are required to submit annual audit certification on compliance with the boundary conditions and annual reporting of key metrics.
- An individual who has been appointed as an appointed representative of any CMS licence holder or exempt FI for the first time, for the period starting on the date of his first appointment as an appointed representative and ending on the last day of the same calendar year; or
- Appointed representatives who serve only accredited investors, and/or institutional investors.

Technology Updates

Consultation Paper

Consultation paper on Proposed Notice on Cyber Hygiene

On 6 September 2018, the MAS issued a consultation paper on Proposed Notice on Cyber Hygiene. The paper prescribes a set of six essential cybersecurity practices that FIs must put in place to manage cyber threats. FIs must:

- address system security flaws in a timely manner.
- establish and implement robust security for systems.
- deploy security devices to secure system connections.
- install anti-virus software to mitigate the risk of malware infection.
- restrict the use of system administrator accounts that can modify system configurations.
- strengthen user authentication for system administrator accounts on critical systems.

Tax Updates

Monetary Authority of Singapore updates to Singapore Budget 2018.

The following highlights are relevant to Singapore's financial services sector.

Variable Capital Companies (VCC), formerly referred to as Singapore Variable Capital Companies

The MAS released FDD Cir 14/2018, dated 31 October 2018, on the tax framework for VCC.

(i) Tax framework for VCC

- A VCC can be set up as a standalone (with no sub-funds) or umbrella VCC (with sub-funds). In both cases, the VCC will be treated as a single entity for income tax purposes.
- An umbrella VCC and its sub-funds will only need to submit one set of income tax returns to the Inland Revenue Authority of Singapore (IRAS).
- Singapore tax-resident VCC (both standalone and umbrella VCCs) will be able to access Singapore's tax treaties. Where a VCC is considered a Singapore tax resident, a Certificate of Residence (COR) will be issued to the VCC, with the names of the relevant sub-funds included on the COR to enable all relevant entities to gain access to Singapore tax treaties.
- Further details on the tax framework for VCCs is expected to be released by IRAS in 2019.

(ii) Tax incentive schemes (Section 13R or Section 13X)

- The tax incentive schemes for funds under Sections 13R and 13X of the Singapore Income Tax Act (SITA) will be extended to VCC.
- In the case of an umbrella VCC, the VCC which is the legal entity can apply for the tax incentives on behalf of its sub-funds.
- Tax incentive conditions under both schemes and the corresponding economic commitments are to be applied on the umbrella VCC (as opposed to its individual sub-funds).
- For addition of sub-funds to an umbrella VCC, MAS notification or approval is not required as long as the umbrella VCC (and its sub-funds) continue to invest within the scope of what the umbrella VCC fund is mandated to do via its offering document and approved under the Section 13R / 13X scheme.

(iii) Financial Sector Incentive – Fund Management (FSI-FM) scheme

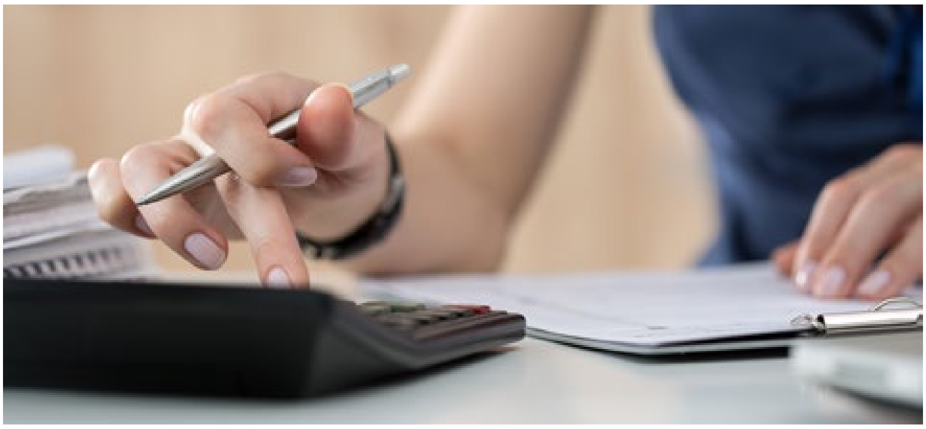
- The 10% concessionary tax rate under the FSI-FM scheme will be expanded to include fee income received from managing / advising incentivised VCC.

(iv) GST remission for funds

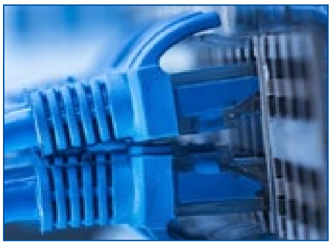
- Funds that meet all qualifying conditions will be able to recover GST incurred on expenses based on a fixed recovery rate without having to register for GST. The fixed recovery rate is determined annually based on the proportion of taxable supplies made by the industry.
- GST remission will be extended to the VCC if it satisfies the conditions for income tax concession as a Section 13R or 13X fund as at the last day of its preceding financial year. The VCC must also be managed or advised by a prescribed fund manager in Singapore.
- Under the remission, sub-funds of qualifying umbrella VCCs will be entitled to input tax claims on GST incurred at the fixed recovery rate.
- Further details will be released by IRAS in 2019.

(v) Withholding tax exemption for funds

- Certain payments made by qualifying funds managed in Singapore by prescribed fund managers may enjoy withholding tax exemption.
- To qualify for exemption in the current financial year, the VCC must satisfy the conditions for Section 13R / 13X incentives throughout the relevant period.

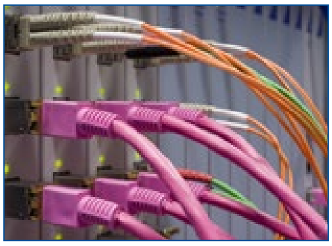


Global topics



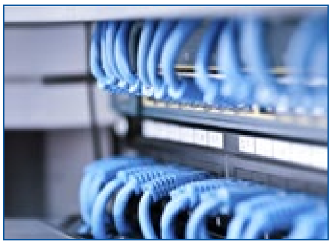
EBA on fintech

This paper by the European Banking Authority (EBA) discusses the risks to incumbent banks, payment institutions and electronic money institutions and also takes a look at consumer protection issues and regulation of new fintech firms.



Fintech regulation: Turning a corner

The Basel Committee on Banking Supervision has issued a sound practices note on fintech, focusing on response to risks, safety and soundness of banks and financial stability, and treatment of customers, product development and approval, and anti-money laundering.



Fintech credit

This paper by the Financial Stability Board and the Committee on the Global Financial System discusses the risks posed by fintech developments, with special focus on credit facilitated by electronic platforms.

Fintech100: The world's leading fintech innovators

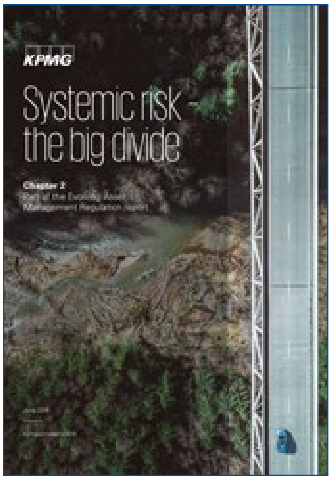
Fintech100 features the 'Leading 50' fintech firms from around the globe – ranked based on innovation, capital-raising activity, size and reach; and the 'Emerging 50' – exciting new fintechs that are at the forefront of innovative technologies and practices, and which are pursuing new business models.

LiST19: The countdown begins

The European Central Bank (ECB), concerned about European banks' liquidity risks, is conducting a major dedicated stress test of liquidity in 2019. Most banks should have little to fear but failing to prepare could be a costly error.

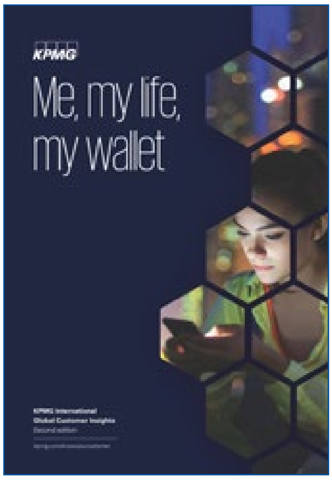
The next generation of model risks

The ECB has increased its attention on models and how they affect management decision making and overall understanding of risk. However, as a latecomer to the topic of model risk, will current European guidelines be sufficient to safeguard banks and their customers?



Systemic Risk – The big divide

Today's views on the systemic risk that investment funds present could hardly be more divergent. The FSB has issued policy recommendations to address structural vulnerabilities from asset management while IOSCO has issued revised guidelines on liquidity risk management in funds and is working towards globally-accepted measures of leverage.



Me, my life, my wallet

This report explores the multidimensional customer, what is truly driving behavior and choices, and how this is set to change as the customer of tomorrow emerges.

RFR regulatory round-up

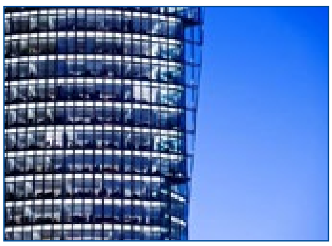
This is a regulatory summary of the latest updates from key parties including FCA, PRA, ISDA, the ECB, CME and IBA. In this issue, we take a look at several significant developments in the transition towards alternative risk free rates.

Outsourcing NPLS: An emerging trend

The growth of non-performing loans (NPL) outsourcing has not gone unnoticed by the European banking authorities. What are the key regulations banks should consider when making strategic decisions over NPL outsourcing? And how should banks prepare for further supervisory focus on this topic?

Cyber insurance: An opportunity to lead in a growing market

The need for cyber protection is growing and creating significant opportunities for insurers to proactively raise take-up of cyber insurance and build customer trust.



Trends in supervisory on-site activities

Since the introduction of the Single Supervisory Mechanism, on-site inspections of banks have increased scrutiny and forced banks to increase their effort to remain compliant while also tackling growing levels of regulation. How can banks better prepare for potential on-site inspections?

To obtain any of the reports, please send a request to sg-marketing@kpmg.com.sg

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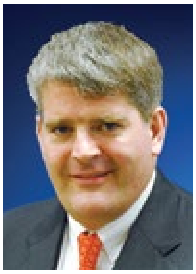

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