Secretariat to the Committee on Payments and
Market Infrastructures
Bank for International Settlements
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Via Email (only): cpmi@bis.org

Subject: Facilitating increased adoption of payment versus payment (PvP)

Australian Payments Network (AusPayNet) welcomes the opportunity to respond to the Committee on Payments and Market Infrastructures (CPMI) consultative report *'Facilitating increased adoption of payment versus payment (PvP)'*.

About AusPayNet

AusPayNet is the industry association and self-regulatory body for the Australian payments industry. In this core role, AusPayNet manages and develops regulations, procedures, policies and standards governing payments clearing and settlement within Australia.

We bring together service providers, government, regulators and end-users to improve the Australian payments system. We do this by promoting competition and innovation, delivering efficiency and controlling systemic risk; this creates a shared purpose that engenders confidence in the payments system. We have over 150 members, including financial institutions, merchants, payment system operators, and other payments industry stakeholders.

In forming this response, AusPayNet has leveraged that membership in consulting financial institutions (primary respondents given the focus of the consultative document), on the specific feedback questions raised, to provide a response on behalf of the Australian payments industry.

Summary Overview

Australia broadly agrees with the CPMI's conclusions on the causes of non-PvP settlement, these being:

- The lack of availability of PvP platforms, particularly for emerging market economy currencies; and
- Fit for purpose platforms that optimise liquidity usage and mitigate settlement risk in suitable operating windows; and
- Efficient platforms where the business case for participation and the benefit of participation substantively outweigh the cost of participation and deliver on the reduction of settlement risk.

AusPayNet members support the CPMI and central banks' ongoing analysis of the causes of non-PvP settlement and engagement with the private sector to identify and lower the barriers to existing and new PvP arrangements.

1. Do you agree with the analysis of the causes of non-PvP settlement?

Existing PvP arrangements have been successful at reducing settlement risk for much of the foreign exchange market, no more exemplified than by the ability of the foreign exchange markets' to continue to function through the global financial crisis in 2008. Expansion into other currencies though has been limited with the last currency joining CLS, the current market leader for PvP services, in 2015. To date, CLS settles 18 currencies, the majority of which would be classified as belonging to Advanced Economies (AE).

It is clear that there is a lack of availability of PvP arrangements in Emerging Market Economies (EME). It is noted by the 2019 BIS Triannual Survey that there is significant ongoing growth in EME trading, particularly the Chinese Renminbi, which is neither available on CLS nor available for netting but can be gross settled across various Nostro providers in offshore markets. The proportion of trades settling without PvP arrangements, and therefore the protection PvP provides, is growing, and this trend represents an increasing threat to global financial stability.

Successful PvP arrangements must reduce both settlement risk and funding costs. In order to substantiate the business case for participation, the benefit of participation must substantively outweigh the cost of participation. That the cost is prohibitive, and the technical requirements are significant is evidenced by such a small number of direct CLS Settlement Members (76) with a substantially smaller number of that cohort offering third party services. That small number are supporting access to 30,000 third-party end clients.

Non-PvP arrangements for liquidity management using netting, bilateral and/or multilateral, have both advantages and disadvantages. The disadvantages, particularly those of cost and technical complexity need to be analysed further and addressed so that the benefit of PvP settlement arrangements clearly outweigh the disadvantages. Outside of CLS, there are very few PvP or netting arrangements that are available. Some, such as CHATS in Hong Kong and CCIL in India have been largely designed to meet domestic market needs and have restrictive access regimes.

There has also been a noticeable global shift limiting global banks offering CLS outside of their home currencies/countries. They still provide Nostro services domiciled in financial hubs to facilitate PvP settlement which can result in a dependency on intraday liquidity limits, such as unadvised and uncommitted lines of credit. These are at the discretion of the Nostro bank provider. These funding arrangements typically result in funds not being paid or released until proceeds are paid into the Nostro accounts. When used in such a way, these arrangements do offer a quasi PvP, but actual PvP would still be preferable.

Our members agree that the availability of and access to PvP arrangements is a significant contributing factor to non-PvP settlement. Moreover, cost and technical complexity are also significant inhibitors of take-up.

2. Do you find that, for your market segments, some causes are more important than others? Please explain.

Our members have a large bias towards AE currencies that are generally settled using CLS. Nonetheless, the paper identifies that EME currencies are increasingly being traded, which our members would be keen to see on a PvP platform from a risk perspective.

The inability of foreign exchange participants to settle using PvP in some EME currencies continues to perpetuate Herstatt risk. This risk, if realised, will cascade and reverberate across markets with consequences on emerging economies and institutions potentially magnified compared to that of AE currencies that have the protections of a PvP platform. When looking at EME currencies from the perspective of AE commercial banks, there are additional considerations with respect to credit and country risk for higher risk jurisdictions. This is exacerbated where there is an increase in geopolitical concerns wherein the credit exposure or risk of non-repatriation of funds may be unacceptable. This often results in the preference for global bank counterparties as opposed to local banks, and, to an extent, hampers the delivery of PvP settlement.

We note here that the majority of South-East Asia and Oceania currencies have no access to PvP via CLS, CHATS or any other scheme.

3. In which currency pairs or products do you find that non-PvP settlement is increasing?

Our members have indicated an interest in the following currency pairs to be included in PvP arrangements:

CNY/AUD

CNY/USD

CNY/EUR

THB/AUD

THB/USD

THB/EUR

IDR/AUD

IDR/USD

IDR/EUR

In addition to the above currency pairs, the market segments of spot, forwards, same-day/real-time trades and swaps is deemed desirable to be settled using a PvP platform.

Our members do note that the majority of the large investments or capital flows is primarily conducted in USD terms. In addition, some of the above currencies have central bank capital controls and are non-deliverable.

4. Do you agree with how the proposals for new solutions could increase adoption of PvP?

Given expanded RTGS hours are unlikely to be realised in the near term, beyond the global settlement window, the exclusive use of central bank money could be an impediment to increased use of PvP. As such, incorporating the use of commercial bank money may well be an opportunity to expand the scope of PvP to include a more currencies and, where the business case avails itself, netting capabilities.

Due to the large range of potential currency pairing arrangements, prioritisation in the use of PvP may be needed. To some extent prioritisation could be determined by volume and value of FX trading in non-CLS currencies, or other factors, such as volume of trading in various market segments. In effect, the use of PvP should be prioritised to de-risk those markets at most risk.

Alternate solutions at a regional level could be explored given that many regions have strong trading relationships, even though they may well be using a bridging currency such as USD. BUNA and CHATS are examples of regional cooperation and as such could have potential to be emulated in other regions should there be sufficient cooperation and where a business case can be established. To some extent, this may also mitigate the need for 24/5 operations, yet deliver the principle aims of reducing risk and costs attributed to FX settlement.

From a hierarchical perspective, netting is superior to gross settlement. Netting, using bilateral or multilateral netting systems (such as CLS), lends itself to consistent processes, which promotes automation, which in turn reduces the risk of incorrect settlement of trades. Settlement netting reduces settlement and operational risk by reducing the overall number of settlements required. Moreover, it is a significantly more efficient method for funding, capital and balance sheet management. It can also reduce the costs attributed to FX settlement.

The proposed PvP settlement approaches, be they with commercial bank money, central bank money, or a combination of both should also where possible offer netting functionality. Such attributes are likely to increase the adoption of PvP. It is imperative that all PvP platforms have a clear legal basis that governs settlement finality and have appropriate supporting rules and procedures that define the point of settlement. Moreover, adherence to the Principles of Market Infrastructures (PFMI) will assist with confidence. In addition, preference would likely be to those PvP models that either use central bank money or have significant oversight by a central bank, and where a central bank can inject liquidity in a crisis. This alone will not guarantee adoption. Each solution must address the disadvantages, particularly those of cost and technical complexity, so that the fundamental benefits of PvP settlement arrangements clearly outweigh the disadvantages. Doing so will enhance the appeal of PvP settlement and consequently increase adoption.

5. Do you find that these new solutions, together, if launched successfully, can mitigate settlement risk? Please explain.

Greater inclusion in PvP settlements systems of EME currencies and jurisdictions will mitigate settlement risk. Increasing the volume of PvP settlement platforms, though, could lead to the risk of fragmentation of standards which would elevate cost to participants, particularly if they access multiple PvP settlement providers. Hence, some level of standardisation and interoperability would need to be applied in order to ensure cost and fragmentation do not become an obstacle to adoption.

Our members echo the comments of SWIFT, 9th Gear and CLS with respect to leveraging existing technologies and standards protocols. This should address the commentary noted in the paper by EME jurisdictions in that it would reduce the need for large-scale disruptive technology changes, particularly for those jurisdictions with more vanilla needs, and enhance the opportunity for interoperability. This should not preclude the adoption of newer technologies at a later stage nor the optionality of additional offerings, such as APIs for access and integration or other services, such as KYC.

The ability to remove bridging currencies for EME cross-border payments would be worthy of further consideration, though our members do not see this as a priority. Solutions aimed at entry level jurisdictions where the needs are more basic, and the principal aim is simplicity and risk reduction, must establish a business case for participation where the benefit of participation substantially outweighs the cost of participation.

6. Do you agree with the analysis of the barriers to increased adoption of PvP?

The paper has articulated a number of barriers to increasing the adoption of PvP. Whilst the conventions around value date, nostro operating hours, and interoperability between legacy and emerging systems are important, the fundamental cost-benefit equation should be addressed in the first instance.

Central banks and other public authorities can and should address regulatory barriers where they exist and provide appropriate regulatory incentives that, in tandem with the cost-benefit equation, make for a compelling business case for increasing the adoption of PvP settlement by FX participants. To that end, a holistic assessment of the benefits, risks and barriers by central banks focused on their individual jurisdictions and regions would likely reveal more insights, particularly around the challenges, that would allow for a calibrated response.

7. Which barriers do you find most significant, and do you observe barriers that are not identified in the report? Please explain with specific reference to individual barriers.

Our members have identified three principal barriers to the adoption of PvP settlement, these being cost, complexity and access.

Our members have also suggested that if there is a proliferation of PvP settlement platforms with substantially differing standards that are not interoperable, this will add a further obstacle to adoption as it introduces additional complexity and cost.

Other barriers include the reduced number of banks available to provide CLS facilities, particularly the global banks offering services outside of their home currencies, which is becoming apparent and significant. This is particularly evident when coupled with reduced credit, counterparty and country risk appetites, which leave smaller domestic banks at a significant disadvantage.

It is also noted that capital controls, particularly in EME, can result in capital, investment and trade flows being conducted in USD, making EME currencies less attractive to deal in and creating an additional barrier to PvP settlement processes.

8. Do you agree with the possible roles for private and public sector stakeholders in addressing the barriers?

We agree with the possible roles for private and public sector stakeholders in addressing the barriers.

9. Do you find that the private sector could take on other roles in facilitating increased adoption of PvP?

Whilst the private sector can take on further roles, it must be within a framework that builds on a foundation that offers legal certainty and has the capability to build trust in solutions. Central banks have largely built that trust, which provides them with a significant advantage over private sector initiatives. Perhaps there is potential for central banks to partner with the FSB's identified global systemically important banks to identify other opportunities. However, the opportunity for partnership may lie with regional systemically important banks to develop solutions.

Building on the regional theme, analysis of currency pairs and market segments may help assess whether region-specific solutions will promulgate a faster uptake of PvP. This could reduce the requirement for extending operational and RTGS hours unnecessarily, which in turn could also negate some of the settlement/value date issues, particularly for Oceania due to time-zone differences.

10. How could the public and private sector work together to take this forward? Please explain and suggest any practical actions that could be taken by existing industry bodies.

There is an opportunity for central banks to collaborate with commercial banks and other stakeholders, such as government, for creative solutions. The community of countries within the Asia Pacific Economic Cooperation (APEC) accounts for 48% of global trade in goods and commercial services and is an example of a body that could explore regional solutions in partnership with central banks. Other communities such as ASEAN, could be used to assist in the identification of willingness and opportunity in the first instance, followed by technical assistance as required. Design and build could be where the public and private sector work together, be that using liquidity bridges, variations on the Scandinavian Cash Pool, or expansion of access to existing PvP systems such as CHATS.

In Australia the introduction of RMB settlement was driven by both private and public sector using Austraclear which is enabled with both AUD and CNY (CNH offshore). The Austraclear platform with Bank of China' Sydney branch enables connectivity to CHATS RMB, CIPS &

CNAPS in Mainland China. Austraclear is enabled with AUD & Offshore CNY; expansion to other currencies and development of PvP could be of benefit to the region.

We appreciate the opportunity to consult with the CPMI on this important issue and welcome any further dialogue on the consultative report *'Facilitating increased adoption of payment versus payment (PvP)*'. Please contact David O'Mahony, Business Analyst (domahony@auspaynet.com.au) if you have any further questions.

Yours sincerely

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