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Committee on Payments and Market Infrastructures
c/o CPMI Secretariat
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
SWITZERLAND

By email: cpmi@bis.org

Re: Consultative Report on Facilitating Increased Adoption of Payment Versus Payment (PvP)

To the Secretariat to the Committee on Payments and Market Infrastructures:

The Clearing House Payments Company L.L.C. ("TCH")[1] appreciates efforts by the Committee on Payments and Market Infrastructures ("CPMI") to solicit stakeholder input on its July 2022 consultative report *Facilitating Increased Adoption of Payment Versus Payment (PvP)* ("PvP Report")[2] and respectfully submits these comments on behalf of itself and its owner banks. TCH understands the PvP Report represents part of the CPMI's broader engagement relating to Building Block 9 of the G20's roadmap to enhance cross-border payments. TCH believes the PvP Report thoughtfully describes the landscape for payment versus payment ("PvP"), including some of the obstacles that dissuade users from settling certain foreign exchange ("FX") transactions through existing PvP arrangements.

At the same time, TCH believes the PvP Report may overstate the problem with respect to much of the FX market. Existing PvP arrangements adequately serve the highest value/volume currency pairs, which are those used in more advanced economies, and new PvP entrants promise further enhancements for those market segments. For emerging market economies ("EMEs"), the PvP Report rightfully cites the need to strengthen local rules to ensure robust settlement finality protection and the depth of those FX market segments as impediments to greater use of PvP; we believe the lack of availability of PvP arrangements for EME currencies is more a symptom of such causes than a cause of the lack of PvP adoption itself.

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[1] The Clearing House Payments Company L.L.C. owns and operates core payments system infrastructure in the United States, clearing and settling more than $2 trillion each day. See The Clearing House's website at www.theclearinghouse.org.

[2] *See* COMMITTEE ON PAYMENTS AND MARKET INFRASTRUCTURES, FACILITATING INCREASED ADOPTION OF PAYMENT VERSUS PAYMENT (PVP) CONSULTATIVE REPORT (July 2022) (hereinafter "PVP REPORT").

If measures are taken to ensure robust settlement finality protection and as EME FX markets become more active and liquid, we anticipate the market will organically turn to greater use of PvP settlement. We therefore recommend that the authorities give market forces time to address the causes of the lack of PvP adoption. As the PvP Report notes, a number of PvP arrangements are already under development that could help close the identified gaps.

We also believe it is critically important that the CPMI recognize there are safe ways to manage FX exposures outside PvP arrangements. We understand that PvP arrangements offer many benefits. But they do not represent the exclusive means to measure, monitor, and manage such exposures. While TCH supports efforts to further the adoption of PvP settlement in appropriate circumstances, it also believes alternative means of managing FX exposures can help ensure fast, safe, efficient, and transparent cross-border payments, consistent with the G20's objectives. Presettlement netting, especially if carried out frequently, can help reduce exposures, for instance.[3] The PvP Report ought to explicitly reflect these alternative means of managing FX exposures, even as its focus is understandably on the promotion of PvP arrangements. This is particularly true since, as the PvP Report observes, there are entry costs (in terms of both time and money) to using PvP arrangements. Those costs will tend to be higher until some level of scale can be achieved. Consequently, it may not be efficient for market participants to immediately turn to PvP arrangements even once their availability is more widespread than it is today; less costly alternatives—for market participants and therefore, ultimately, end users—ought to remain available for use in a safe, prudent manner. After all, our collective objective should be to reduce overall FX settlement risk, and the means of achieving that outcome should be less important than the end. Furthermore, by considering the FX market in isolation—without taking into account the timing and nature of the cross-border payments giving rise to the FX demand—the PvP Report may be underestimating the costs of PvP, overestimating the reduction in risk PvP could achieve, and failing to identify potential tensions with other G20 objectives such as improving the speed of cross-border payments.

In addition to these high-level observations, TCH has responded below to a number of the specific consultation questions the CPMI outlined on page 6 of the PvP Report.

[3] Netting has long been recognized as an effective means of reducing FX settlement risk. In 1994, for instance, the Foreign Exchange Committee sponsored by the Federal Reserve Bank of New York concluded that bilateral netting of payments due between FX counterparties could reduce settlement exposures by as much as 60 percent. *See* NEW YORK FOREIGN EXCHANGE COMMITTEE, GUIDELINES FOR FOREIGN EXCHANGE SETTLEMENT NETTING 1 (Jan. 1997), *citing* RISK MANAGEMENT SUBCOMMITTEE, NEW YORK FOREIGN EXCHANGE COMMITTEE, REDUCING FOREIGN EXCHANGE SETTLEMENT RISK (Oct. 1994) (*reprinted in* FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 1994 24–50 (1995)). The current FX Global Code, while appropriately urging the use of PvP settlement where practicable, otherwise encourages the netting of FX settlement obligations to reduce the size and duration of market participants' settlement risk. *See* GLOBAL FOREIGN EXCHANGE COMMITTEE, FX GLOBAL CODE 38 (updated July 2021).

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

We believe the PvP Report accurately captures the principal reasons FX transactions are settled at times outside a PvP arrangement. Fitness for purpose and efficiency, as described in the PvP Report, are key drivers as to why market participants use (or do not use) PvP arrangements. We believe availability, as described on page 9, might be more properly described as a consequence of a combination of regulatory and market forces that lead PvP arrangements to not cover particular market segments than a direct cause of non-PvP settlement in and of itself, however. The discussion on page 10 implicitly acknowledges that market participants act rationally in using PvP arrangements when it makes sense for them to do so. In promoting PvP settlement to reduce FX settlement risk, the public sector should ensure a level playing field for all market participants to avoid unintended distortions in the FX market.

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

While we do not have access to data that would shed light on this question, we have no reason to doubt the PvP Report's conclusion on page 7 that the increase in non-PvP settlement is "notably driven in part by increased trading in EME currencies." The relative share of PvP versus non-PvP settlement stated in the PvP Report generally accords with the observations of certain of our members for the markets they serve.

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

and

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

At the outset, we note that the solutions described in the PvP Report reflect views expressed by those who responded to the CPMI's call for ideas. Without a great deal more information about the solutions, it is impossible to know whether any one of them, or a combination of these solutions, would increase the adoption of PvP. We are even uncertain based on the descriptions of the solutions whether all are true PvP solutions. The CPMI itself, with access to presumably more information than was included in the PvP Report, was careful to note in the report that it had not assessed the solutions' suitability.

As the PvP Report observes, mere availability of a PvP arrangement does not necessarily mean it will be used by market participants. The available solutions must also prove, as the report puts it, "fit for purpose" and must be efficient. Moreover, as stated on page 27, changes such as extending operating hours are unlikely, in isolation, to yield appreciable benefits without the cooperation of market participants, which might need to invest in internal system upgrades and operational processes to utilize extended settlement windows.[4] Furthermore, as the report acknowledges on page 19, broad adoption and market support are critical to achieving network effects. Therefore, while it is possible that the solutions outlined in the PvP Report will reduce FX settlement risk to some degree, it is uncertain how successful they collectively will be and therefore how much FX settlement risk they will mitigate in the aggregate.

The solutions outlined in the PvP Report are not the only solutions being developed in the cross-border/cross-currency marketplace. For instance, the immediate cross-border ("IXB") solution announced by TCH, EBA CLEARING, and SWIFT will reduce overall risk in cross-border real-time payments. The IXB solution will synchronize the settlement of a U.S. dollar-denominated payment over the RTP network initially with the settlement of a euro-denominated payment over the RT1 network. The IXB model could be extended to other payment systems, including high-value payment systems, as they complete their migration to ISO 20022-based messaging and extend their operating hours. Another example is the Singapore-based technology platform Partior. Partior has piloted a platform that allows correspondent banks to record and update nostro account balances of participating institutions to settle payments between participants using smart-contract technology and blockchain ledgers. The platform is currency agnostic and is technically capable of handling any currency a correspondent bank wishes to support on the platform on a 24x7 basis. In the future, Partior anticipates being able to support simultaneous gross settlement between currencies through the use of smart-contract technology that will enable atomic settlement across currencies. Solutions such as Partior may be a desirable supplement to CLS and other established PvP solutions because they have the potential to support a wide range of currencies and because they benefit from new technologies that can enhance availability and settlement time. Such solutions may also be an attractive choice for institutions in terms of integration cost by providing the infrastructure to settle other types of payments. Still, as emphasized elsewhere in this letter, such solutions may benefit from cross-jurisdictional clarity on settlement finality and value dating.

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

We agree with the PvP Report that the barriers that have resulted in slow uptake of certain existing PvP arrangements would likely similarly constrain the broad adoption of new solutions. Those barriers include weak incentives for users to settle FX transactions on a PvP basis, technical challenges for PvP providers to transact with real-time gross settlement systems during operating hours that meet market participant needs, and differences in regulatory requirements that PvP providers find challenging to reconcile. In addition, as previously stated, the lack of robust settlement finality protection serves as a barrier to increased adoption of PvP in certain jurisdictions. Moreover, if particular currency markets do not have sufficient depth (in terms of volume or liquidity), it may be challenging to attract a PvP arrangement to serve those markets. The robustness of the settlement finality regime might be one factor—but not the only

[4] To be clear, regardless of whether extended operating hours make a meaningful difference in the adoption of PvP settlement, TCH strongly supports moving real-time gross settlement ("RTGS") systems toward 24/7 operations, which could produce myriad benefits beyond FX settlement risk reduction.

one—contributing to whether a particular market has sufficient depth. Last, the increasing need to conduct cross-border payments in real time, without advance instructions that might offer FX providers the opportunity to leverage separate PvP settlement systems, may contribute to market participants' reliance on risk mitigants other than PvP settlement in the FX market. Alternatives to PvP arrangements may be necessary at least until such time as PvP settlement is practicable, efficient, and fit for purpose for such real-time cross-border payments. Furthermore, other changes to market infrastructure, such as the expansion and alignment of operating hours and the enhancement of cross-jurisdictional settlement finality protection, may be necessary to achieve the desired end state. These changes are largely the focus of other building blocks for the G20 roadmap.

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

Naturally, the increased adoption of PvP settlement—the focus of the PvP Report—is just one of the building blocks to the G20's vision of faster, cheaper, and more transparent cross-border payments. As the operator of several payment systems, TCH views FX settlement risk as just one component of the broader landscape in which cross-border payments take place, however. As we have previously conveyed, we believe the most significant challenge to faster, cheaper, and more transparent cross-border payments in general remains the application of economic sanctions screening, as well as anti–money-laundering and countering the financing of terrorism measures.[5] TCH therefore reiterates its call for the public sector to vigorously address compliance-related friction in cross-border payments. TCH's June 2022 letter to the Financial Stability Board suggested three concrete ways to do so: (1) permitting cross-border payments to be screened at fewer points; (2) shifting toward endpoint-based customer due diligence rather than individual payment-based compliance, and (3) establishing a value threshold below which some degree of compliance relief is provided.[6] Greater consistency in regulatory, supervisory, and oversight approaches to these matters across jurisdictions—the objective of Building Block 4 and other components of focus area B of the G20 roadmap, expanded to encompass sanctions—would simplify compliance and likely improve desired outcomes.

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

We support the efforts of central banks and other public authorities to tackle regulatory barriers that inhibit PvP adoption. These would include efforts to strengthen the legal regimes in those jurisdictions that do not sufficiently provide for robust protection of settlement finality,

[5] *See* TCH Letter to Financial Stability Board on G20 Roadmap for Enhancing Cross-Border Payments (June 15, 2022), https://www.theclearinghouse.org/-/media/new/tch/documents/advocacy/tch_fsb_cmts_compliance_friction_cross-border_payments_06-21-2022.pdf.

[6] *See id.*

which is a precondition for the safe expansion of PvP arrangements to currencies in those jurisdictions. We also support efforts to report and measure settlement risk exposures in a more standardized way, including capturing the full duration of exposures. Such efforts would be consistent with, and would further progress in, focus area B of the G20 roadmap.

On the private-sector side, we agree that exploring an international value date convention could help lower barriers. The lack of such a convention can make it more challenging for counterparties to agree upon a settlement date and time. Furthermore, with currency legs often settling in different time zones and sometimes even across the International Date Line, the lack of such a convention can contribute to confusion as to when settlement will occur. We therefore believe introducing an international value date convention could enhance the efficiency and effectiveness of FX settlement and contribute to the reliable measurement and monitoring of FX exposures. We further believe the private sector, working through industry forums, ought to lead this effort.

We also urge the public sector to expand and align operating hours of RTGS systems, as suggested by the PvP Report. Indeed, earlier this year, the CPMI itself cited reduction of settlement risk as one reason to pursue such expansion and alignment.[7] Since, as the PvP Report notes, the U.S. dollar is on one side of 88 percent of all FX trades, expanding U.S. RTGS system operating hours to maximum availability (24x7) would benefit the FX market as a whole.[8] As a corollary, as the share of EME currencies rises in the FX market, it will become increasingly important for the RTGS systems in those jurisdictions to expand and align their operating hours.[9] To be effective, as our response to question 5 indicates, expanding and aligning RTGS system operating hours will need to be complemented by market participant cooperation. Moreover, an expansion and alignment of RTGS system operating hours would likely result in benefits to the speed, efficiency, and cost of cross-border payments beyond the reduction of FX settlement risk, which is the focus of the PvP Report.

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

The private sector is best positioned to provide innovative solutions that support increased adoption of PvP. The number of proposed new solutions described in the PvP Report that stem from the private sector is indicative of this creativity and determination to increase PvP adoption. In addition to the types of services described in the PvP Report, the private sector has been actively developing and applying new technology to enhance clearing and settlement efficiency and to achieve risk reduction, such as the Partior platform we mentioned above.

[7] *See* COMMITTEE ON PAYMENTS AND MARKET INFRASTRUCTURES, EXTENDING AND ALIGNING PAYMENT SYSTEM OPERATING HOURS FOR CROSS-BORDER PAYMENTS FINAL REPORT 8 (May 2022).

[8] *See* PVP REPORT, *supra* note 2, at 8 (U.S. dollar share of trades).

[9] *See id.* (market share of EME currencies rising, reaching 25 percent of global turnover in 2019).

Consequently, we encourage the public sector to act in ways that support private-sector efforts without imposing new mandates on private-sector actors.

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

As noted above, we believe it is critical that the public sector recognize that PvP arrangements are not the sole means of mitigating FX settlement risk. We concur with the PvP Report's observations that FX exposures need to be measured, monitored, and managed. But we also believe that banks and other market participants can and do take actions to help ensure those exposures neither imperil themselves nor the broader financial system and economy. We therefore urge the CPMI to recognize that alternate approaches to measuring, monitoring, and managing FX settlement risk are also valid. At the same time, private-sector participants can and should take meaningful steps to encourage further adoption of PvP settlement through existing industry forums, while the public sector tackles regulatory obstacles to successful adoption, including by enhancing the rules underpinning settlement finality in those jurisdictions that currently lack robust protections. By working together and in parallel, TCH believes the two sectors can reduce settlement risk in this key market.

TCH appreciates the opportunity to provide comments to the PvP Report. If you have any questions or wish to discuss this letter, please do not hesitate to contact me using the contact information above.

Yours very truly,

/s/ Stephanie A. Heller

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