

# Recommendations for Regulating and Supervising Bank and Non-bank Payment Service Providers Offering Cross-border Payment Services: Consultation report

## Response to Consultation

### Institute of International Finance

#### *Introduction*

**1. Do the definitions contained in the report provide sufficient clarity and establish the common understanding necessary to facilitate the practical implementation of recommendations proposed in this report?**

- Generally, the definitions provide sufficient clarity (subject to our comments in response to questions 2, 3 and 4).
- We note that the discussion in the definition of payment service provider (PSP) states that the report focuses on services offered directly to end-users including consumers and businesses, but it is unclear how this meets the overall objective to consider frictions within the payments ecosystem.

**2. What adjustments are required to the draft definitions to improve clarity?**

#### Activity-based regulation and Entity-based regulation

- The distinction between activity-based and entity-based regulation could be further elaborated, particularly in how these approaches interact in practice.
- The definition of activity-based regulation says these are “usually prescriptive”; we respectfully disagree. The extent to which regulation is prescriptive vs. principles-based has more to do with the regulatory philosophy of the jurisdiction in question rather than the approach to entity vs. activity-based regulation.
- We would also question whether compliance ensured by “sanctions and other enforcement actions” are specific to activity-based regulatory approaches and would contend this approach is equally applicable to entity-based regulation.
- We would suggest that in its final recommendations report, the FSB include a discussion of hybrid approaches that combine both activities-based and entity-based regulation, such as seen for instance in the EU where there are entity-based licences for banks and non-

banks alike, alongside a 'fit for payments' framework in the Payment Services Directive (PSD2), and in the proposed PSD3 and Payment Services Regulation.

## Payments

- Recognizing the short consultation for this report over a busy holiday period, the IIF looks forward to continuing to work with the FSB on a definition. The definition of cross-border should be considered further to recognize modern payment methods, including netting / bundling of payment transactions, as well as the use of virtual currencies, intermediaries, and Payment Market Infrastructure (PMIs) as part of the end-to-end payment journey. Any definition should also remain technology neutral.

## Payment service providers

- We would suggest adding digital payment wallet providers to the definition of PSPs, as this is especially relevant in light of the growing trend of large technology platforms entering financial services.
- It may be helpful to competent authorities and PSPs if real-life examples were given to clarify what types of non-bank PSPs should be in / out of scope, building on the list of examples in the discussion of PSPs on p. 6. Particular edge cases our members have raised include Marketplace operators, Banking as a Service (BaaS), and Resellers.

### **3. What other terms should be defined in this section?**

- The term payment services is not defined. We feel this could be linked back to the definition of payments (e.g. "services relating to payments" or similar), or to the discussion of PSP.
- We also feel it is unclear as to whether or not third-party payment providers (TPPPs) are intended to be covered by the report. We would suggest, if so, that a definition of TPPPs, building on the concept of third-party service provider utilized by the Basel Committee on Banking Supervision (BCBS), may be appropriate. Some members suggest the concept of Third Party Providers similar to the EU PSD3/PSR under development, which might offer insights for Open Banking, too.
- It may be useful to include a definition of Banking-as-a-Service (BaaS), building on the box on p. 17-18.
- Other terms that may require definition include Open Banking and Application Programming Interfaces (APIs).
- We also believe that the report should both define and consider the role of intermediary PSPs. This role is most often carried out by banks and due to the nature of business models/bulked payment flows, often has limited visibility into the true originator and beneficiary of any given payment. In such cases, accountability and responsibility will need to lie on the non-bank PSPs to ensure that the underlying payments are being screened and monitored appropriately and that they have an effective end-to-end control framework. Innovation in non-bank PSP business models has increased the number of intermediaries

involved in cross-border payments and those involved in the payment legs, making this concept important.

**4. Does the explanation regarding the scope of the report provide sufficient clarity to promote the intended understanding of the recommendations?**

- The paper could benefit from more explicit discussion of how the recommendations apply to emerging payment service models, particularly those involving partnerships between banks and non-banks.
- Additionally, more clarity on how the recommendations interact with existing international standards, such as those from FATF and BCBS, could be very beneficial.
- There should also be a recognition that cross-border transfers can be effected via a series of domestic payments. The understanding of the risks associated with this payment flow and how the risks can be managed will impact regulatory requirements and supervision.
- See our comments above on the desirability of the analysis, taking note of business models that include netting/bundling and cryptoassets, and of more worked examples.

*Section 1: The role of banks and non-banks in cross-border payments*

**5. Do the descriptions of the roles of banks and non-banks in providing cross border payment services adequately reflect current practices?**

- We appreciate the FSB's recognition that both banks and non-banks are critical in cross-border payments and in facilitating global trade.
- In many jurisdictions across the world, non-bank payment service providers are already regulated based on their activity. And there are hybrid approaches combining entity-based and activity-based regulation, e.g. in the EU and the UK. The key consideration is to ensure that the activity-based regulation is 'fit for payments' – i.e. that it appropriately considers the payment activity in and of itself and provides for a constant and uniform approach regardless of the type of entity. Non-bank payment providers are not banks, they do not have the same breadth of activity, and indeed risk, as fully-fledged banks, and it is important that this is appropriately considered in activity-based regulatory approaches. This means their risk is different in various ways, not necessarily uniformly less or more. It is equally important that banks are not subject to entity-based regulatory approaches which affect their ability to undertake payments activity and/or interact with non-bank PSPs on an equivalent basis to non-bank PSPs.
- As highlighted above, the descriptions as they stand do not seem to articulate the increasing complexity of the end-to-end cross-border payment journeys and models. Some phenomena that members observe include:
  - o The growing market for PSPs to provide payment access to PMIs to other PSPs, who sometimes in turn provide access to another PSP, means there can be multiple bank and non-bank PSPs in an end-to-end payment chain.

- o The extent to which some PSPs offer these services to small businesses alongside or as part of other services – e.g. accountancy, tax services, payroll etc.
- o The extent to which many PSPs operate on a local collection / local pay-out basis with bulked funding/settlement flows, therefore not following the traditional single payment end-to-end route that correspondent banking uses. The rising presence of crypto-assets in some payment flows even if they are initiated and paid out in fiat currency.
- o Banks and non-bank PSPs may cooperate out of business choice or for regulatory reasons (for example in those jurisdictions where non-bank PSPs do not have access to central bank run infrastructure or services).

## *Section 2: Cross Border Payment Frictions and Risks*

### **6. What additional risks or frictions, within the scope of this report, are created by potential inconsistencies in the legal, regulatory and supervisory frameworks applicable to banks and non-banks in their provision of cross-border payment services?**

- Regulatory arbitrage opportunities created by inconsistent application of AML/CFT requirements. For example, across several Latin American jurisdictions analysed in 2021 by a globally active member:
  - o in one jurisdiction, it seemed likely that those PSPs that do not offer services related to credit card operations could be exempt from performing certain money laundering controls and due diligence on their clients;
  - o in another jurisdiction, neither acquirers nor aggregators conducting account opening without being a financial entity or a regulated fintech institution were subject to a framework that established similar obligations for the detection of illicit activities or for client identification and knowledge as applied to credit institutions; and
  - o in a third jurisdiction, the regulations applicable to AML and onboarding established different due diligence requirements depending on the complexity level of the contracted product and the type of obligated subject; e.g., card processors were required to report suspicious operations and implement a limited system for the prevention of money laundering and terrorist financing while financial entities were required to implement "complete" AML systems.
- Challenges arise in risk assessment and management out of emerging, more complex partnership models, like BaaS.
  - o The risk assessment should not take a blanket approach but consider the bank and non-bank sector in a more granular manner, considering that bank and non-bank PSPs take many shapes and sizes, as the report also acknowledges. Without this, businesses can unduly end up being perceived as higher risk than their actual residual risk profile, as we've unfortunately observed in the EU's AML Supranational Risk Assessment (SNRA) process.

o We recommend the FSB consider the impact of mixed activities groups on payments. Mixed activities groups can offer a range of different services to private customers and other financial market participants, including credit institutions and, due to their market capitalisation and existing large userbase and network, have the potential to easily scale up their financial service-related activities. We would invite the FSB to consider firstly how best to assist competent authorities to adequately inform themselves regarding all direct and indirect financial activities conducted by large and complex non-bank groups, to include BigTechs, and encourage the relevant information to be properly shared between the competent authorities. While beyond the scope of this consultative report, the IIF is aware that regulatory approaches to such non-bank groups have been a point of research by the BIS in recent years.

o Large digital platforms that control both the device and the operating system provide a competitive edge to their proprietary payment service. We are increasingly seeing a regulatory gap in how these large digital platforms' proprietary payment services (such as digital wallets) are treated, as they may not be covered by existing rules in many jurisdictions.

- Operational resilience considerations, particularly for non-banks that may not be subject to the same rigorous requirements as banks.

- Data privacy and protection issues arising from different regulatory approaches across jurisdictions tackled elsewhere (recognizing this is not an issue confined to the question of bank vs non-bank supervision, but one of data localization and geopolitical challenges to data frameworks).

- One of the key risks inherent in emerging payment methods is the blinding of the end-user PSPs to the true cross-border nature of the transaction because it is made using domestic rails for one or both legs. There is a consequent need to consider further transparency risk in the financial crimes discussion in the final recommendations report.

- The AML/CFT section of the consultative report refers to two levels of inherent ML/TF risk present in this sector, associated with payment service characteristics (activity-based risk) as well as the characteristics of the PSPs that offer those services (entity-based risk). We are seeing a move away from the traditional money service bureau and agent networks, and more towards e-money institutions (which include agents), digital wallets and prepaid cards (where anonymity is a risk).

### *Section 3: Principles for developing recommendations*

#### **7. Do the identified principles provide sufficient support and appropriately frame boundaries for the recommendations in the report?**

- The principles identified are:

- o Cross-border payment supervisory and regulatory regimes should be designed to promote safe, resilient, and efficient payment services.

- o The supervisory and regulatory regimes applicable to cross-border payment activities should be proportionate to the risks that they present.
- o The supervisory and regulatory regimes for PSPs should respond accordingly to changes in national and international payment services landscapes.
- o The supervisory and regulatory regimes for PSPs should be clearly articulated.
- o The regulatory and supervisory regimes for cross border payments should facilitate cooperation, coordination and information sharing within and across jurisdiction.
- We would identify the following as additional important principles:
  - o Regulatory and supervisory regimes should, to the extent possible, foster innovation and be compatible with open competition.
  - o Payments regulators and supervisors should collaborate with regulators and supervisors in other sectors where this would be necessary to ensure consumer protection in the payments industry.
  - o Public sector actions should not crowd out investments by private sector nor favor public sector providers over private sector providers.
  - o Conflicts of interest within regulatory or supervisory arrangements, such as where a supervisor is also the operator of infrastructure, should be recognized and adequate arrangements put in place to address them.
  - o For cross-border payments, global alignment on standards without “gold-plating” by additional national/regional rules/requirements is generally preferable.
  - o Recommendations should be made and implemented in ways that:
    - take advantage of existing local practices;
    - minimize the impact on local payment ecosystems; and
    - do not jeopardize jurisdiction-specific policy goals, such as the robust entity-level regulation and supervision to which internationally active banks are subject.

*Section 4: Recommendations for improving alignment of PSP regulatory and supervisory regimes*

**8. Are the recommendations sufficiently granular, actionable, and flexible to mitigate and reduce frictions while accommodating differences in national legal and regulatory frameworks and supporting the application of proportionality?**

- In general, we welcome the broad thrust of these recommendations. We note in this recommendation set the choice not to consult on the suitability, or unsuitability, of any aspects of the Basel framework to bank-owned PSPs. Real disparities can arise between

non-banks and banks concerning licensing requirements, AML requirements, capital and prudential requirements, as well as in supervision and enforcement.

- Simultaneously, the IIF would consider unfavourable the prospect of rules originally designed for banks simply being applied to non-bank PSPs in the name of reducing frictions. In this regard, we welcome that the FSB seeks to finalize its recommendations by end-2024. Standards should be risk-based to the activity at hand, and certainty would help the industry as a whole, particularly in what is presently a very competitive and dynamic space.

- The approach as outlined here leaves a great deal of discretion to local regulators and supervisors in how the limited roll-forward of regulation is to take place. Oftentimes, greater local discretion is accompanied by greater risk of fragmentation, so ongoing monitoring of regulatory fragmentation by the FSB would be welcome.

- Member comments on specific Recommendations have been included in Annex 2.

**9. To what extent would the recommendations improve the quality and consistency of regulation and supervision of non-bank payment service providers (PSPs) active in cross-border payments services?**

- The recommendations, if implemented, should notably improve the quality and consistency of regulation and supervision of non-bank payment service providers (PSPs) active in cross-border payments services. Please see Annex 2 for our comments on the wording of the Recommendations.

- It is perhaps more challenging, but nonetheless important, to consider the negative effects to bank-owned PSPs that may in fact result from perceived disparities that are, in some cases, not factual disparities on their face. The perception of such a disparity can, in fact, result in an actual adverse market impact.

- See further answer to question 8 and 12.

**10. For the purpose of identifying material areas to be addressed from a priority and effectiveness perspective, should the report categorise the identified frictions created by inconsistencies in the legal, regulatory and supervisory frameworks applicable to banks and non-banks in their provision of cross-border payments services in terms of focus or order in which they should be addressed?**

- This is a difficult question to answer in abstract. Grouping issues by area of focus is clearly helpful, but so, too, is addressing critical path or urgent matters first.

- All of the frictions interlink, but it would be useful to spell out how resolving one friction goes on to help resolve others, and linking the recommendations to the critical path. For example, recommendation 1 is clearly foundational for other recommendations. By the same token, steps could be taken to implement recommendation 6 concerning cross-border supervision while risk assessments are still being conducted, or frameworks adjusted.

- We do not believe these analytical approaches need to be mutually exclusive, so the analysis could both be thematic and also indicate any dependencies between the recommendations.



- There should also be an indication of timing in the final report. Otherwise, the implementation horizon could stretch out over many years as risk assessments are first conducted, then frameworks adjusted, then guidance given.

**11. Recommendation 5 focuses on domestic licensing. How and to what extent would licensing recognition regimes between jurisdictions support the goal of strengthening consistency in the regulation and supervision of banks and non-banks in their provision of cross-border payment services? What risks need to be considered?**

- Licensing recognition, to the limited extent it does occur in the banking space, depends on important underpinnings in the form of clear home:host responsibilities among banking supervisors, and also mutual trust including through multilateral memoranda of understanding (MOUs) and through mutual membership of the BCBS and/or other regional groupings.
- Licensing recognition for non-bank PSPs should ideally be reached with the same underpinnings. This would imply that clear home:host responsibilities among non-bank PSP supervisors be established, and also multilateral MOUs or membership of trusted supervisory groupings (standing or ad-hoc).
- To the extent that some jurisdictions' regimes are provincial- or state-based and others are nationally based, it may not be realistic to expect licensing recognition in all cases, though this should not impede impactful expansion of such recognition regimes where reasonable and possible.

**12. There are no comprehensive international standards for the regulation, supervision and oversight of non-bank PSPs and the cross-border payment services that they offer. Is there a need for such international standards?**

- In principle, we agree that international consistency of approach and standards could address a number of challenges identified.
- That said, this question would appear a bit beyond the scope of this particular consultative report, specifically as it would require considerable evaluation that the IIF would recommend be instead taken up in a different exercise should the FSB determine appropriate. Such an exercise would need to allot a lengthier timeframe for input, and include a deeper assessment of existing regulatory frameworks for PSPs globally, the various actors in the payment chain, the proportionality of such frameworks relative to the potential of international standards, and weigh cross-border aspects against potentially strong domestic impacts. Such an evaluation could also usefully benefit from the involvement of the Committee on Payments and Market Infrastructures (CPMI).
- Furthermore, we feel that the root cause of many of the challenges identified in the report is the inconsistent implementation of FATF Recommendations into domestic law and/or inconsistent supervision of such domestic laws. Therefore, to be effective, any such initiative would need to be closely coordinated with FATF and be informed by private-sector input.



## *General*

### **13. What, if any, additional issues relevant to consistency in the regulation and supervision of banks and non-banks in their provision of cross-border payment services should be considered in the report?**

- Further, banks (and consequently bank supervisors) arguably have reduced visibility over end-to-end value transfers because of the introduction of emerging bundled or netting-based payment methods within the process of moving the value from originator to beneficiary. This is an important contextual factor for competent authorities to bear in mind in implementing the recommendations, because it increases risk and complexity while limiting bank supervisor visibility. The strong network effects implicit in such business models could also be noted.
- There will always be a trade-off between speed and cost efficiencies for customers and robust financial crime compliance requirements. At the moment, PSPs are increasingly facing conflicting legal and regulatory expectations, including with respect to traditional AML/CFT concerns but also with respect to sanctions enforcement, to keep payments safe and secure, all the while in an era of rising fraud and scams. Given that such measures may be costly to implement and may slow down payments, and the liability implications for PSPs, they may conflict with some G20 objectives of increasing the speed, transparency and inclusiveness of cross-border payments and reducing their cost. More recognition of these trade-offs, and more guidance on how to navigate them, would be helpful from national legislators and regulators and supra-national bodies (including the FSB and FATF).