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TREASURY SERVICES | LATIN AMERICA

# Trending Topics in Payments and Trade

WINTER 2020

## IN THIS ISSUE



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## A Note From Dino Sani, Jr.

**Regional Head of Relationship Management & Business Development for Latin America and the Caribbean, BNY Mellon Treasury Services**

Greetings and best regards. I hope you and your families are safe and well. As most of us adjust to the new normal of a remote working environment, it's remarkable to watch the business community adapt to the widespread impact of coronavirus. On behalf of all of my BNY Mellon colleagues, I want you to know we are with you and committed to serving you with the full strength of our company.

In anticipation of government actions such as these, and to protect our employees' wellbeing and continue to service our clients, we have continued to increase the number of global employees working remotely.

We regularly test our business continuity and resiliency, including remote work testing, to ensure we are prepared to support our clients. Today, a very large percentage of our workforce is working remotely, and we are practicing social distancing for our essential in-office employees. We have sufficient capacity to support demand for concurrent remote use and, due to our robust global footprint, we have the ability to shift work to other regions as needed.

As a result, we are continuing to publish quarterly newsletters for our Latin American clients. In this issue, two articles address areas of concern of which you need to be apprised – one in the field of trade, the other in payments. The first, "Bridging the Trade Gap to Maximize Trade Opportunities," is authored by me, along with Arnon Goldstein, my counterpart in the Asia Pacific region, and by Joon Kim, Global Head of Trade Product & Portfolio Management. The second, "ISO 20022: What You Need to Know," is by Isabel Schmidt, global head of Direct Clearing and Asset Account Services and describes the coming changes in cross-border payments as the world migrates to ISO 20022 messaging. As well, we have an article that celebrates our most long-standing relationships in Latin America.

Most years, I would say that I will be traveling in the region in 2020 and look forward to seeing many of you when I do. That may not prove true this year, but my thoughts will be with you. Stay safe and be well.

Best wishes, Dino

# Bridging the Trade Finance Gap to Maximize Trade Opportunities

**By Dino Sani, Jr., Joon Kim, and Arnon Goldstein**

The global trade finance gap remains a significant impediment to global trade. Standing at US$1.5 trillion, it equates to approximately 9.4% of the US$16 trillion shipped across international borders annually[1]. This is an astonishing figure, representing massive volumes of lost trade opportunities and unfulfilled business growth.

While the gap itself is not a new phenomenon, it has snowballed in recent years, fueled indirectly by heightened compliance requirements – including Know Your Customer (KYC) and Anti-Money Laundering (AML) regulations – introduced in the wake of the global financial crisis. Faced with increased costs, many banks have been forced to de-risk from certain geographies, sectors and transactions that may be viewed as “risky,” or lower value in terms of profit generation. Consequently, smaller businesses in emerging markets are being particularly badly affected.

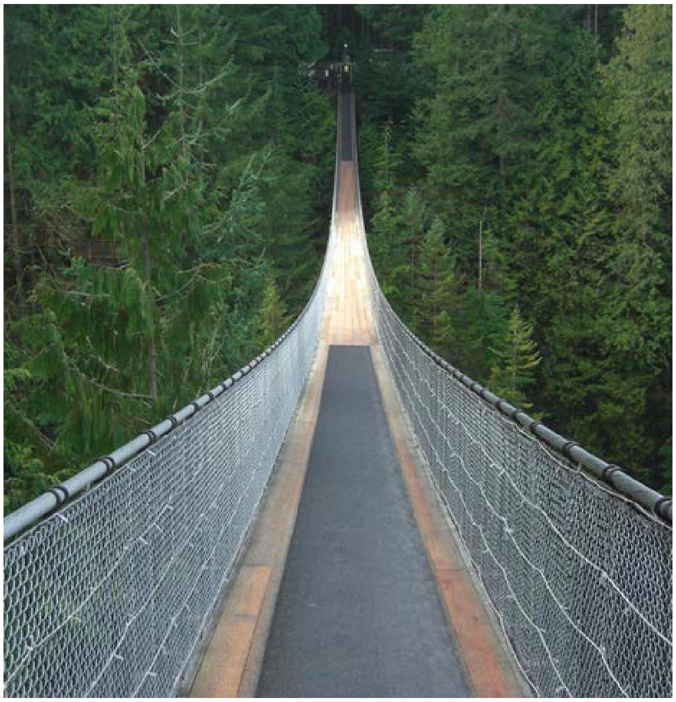
De-risking and the trade finance gap are posing significant challenges to the finance industry in a number of countries in Latin America and the Caribbean[2]. For example, a survey by the Caribbean Association of Banks undertaken in 2017 revealed that 21 of the 23 banks in 12 Caribbean countries had lost at least one correspondent banking relationship[3].

With estimations that between 80 and 90% of world trade depends upon trade finance[4], the availability of such support is essential for a robust, well-functioning trading system. But if businesses are repeatedly unable to access funds to enable their trade activity, this could result in some being cut off from the trading ecosystem – particularly those in smaller countries with limited financial markets[5].

The enduring trade finance gap is compromising global trade activity. And worryingly, the gap may be getting worse. A recent BNY Mellon global survey, *Overcoming the Trade Finance Gap: Root Causes and Remedies*, revealed that trade finance rejection rates were rising in a third of institutions that participated. Furthermore, according to the Asian Development Bank’s (ADB) 2019 survey into the trade finance gap, 58% of respondents expect the gap to increase over the next two years[6].

## Emerging market corridors

The trade finance gap could potentially have a detrimental effect on one of the region’s increasingly thriving relationships: the Latin America-Asia trade corridor. Latin America imports Asia’s competitively priced goods, services and technologies, while Latin America’s abundance of raw materials and



agricultural products is supporting Asia’s rapid economic expansion.

Bilateral trade between Latin America and Asia has grown significantly in recent years, driven by globalization and e-commerce. For instance, bilateral trade with China has increased 25 fold this century, rising from US$12 billion in 1999 to US$306 billion in 2018. This positions China as Latin America’s second-largest trading partner after the US[7].

As both regions look to diversify their exports from the US – particularly in the face of protectionist measures – strengthening and fostering the Latin America-Asia trade corridor is an attractive option.

Yet, the Asia Pacific is also being impacted by the trade finance gap and has, in fact, been identified as the region with the highest number of trade finance rejections – shouldering around 40% of the global trade finance deficit[8]. If businesses in both Latin America and Asia continue to face barriers in accessing trade finance, the true potential of the Latin America-Asia trade corridor may not be able to be realized.

The pressing need to implement solutions to help address the gap is evident, but how can the industry best approach this considerable challenge?

## The voice of the industry

A key purpose of BNY Mellon’s survey was to build an understanding of what industry participants – those at the heart of trade finance – believe could help to reduce the gap. Two

[1] https://www.thebanker.com/Transactions-Technology/Trade-Finance/A-new-age-of-Latin-American-trade-financing-dawns

[2] https://www.thebanker.com/World/Americas/Latam-and-Caribbean-banks-work-to-relieve-pain-of-de-risking/(language)/eng-GB

3 https://www.cepal.org/en/publications/43310-economic-impact-risking-caribbean-case-studies-antigua-and-barbuda-belize-and

4 https://www.wto.org/english/thewto_e/coher_e/tr_finance_e.htm

5 http://www.worldbank.org/en/topic/financialmarketintegrity/brief/de-risking-in-the-financial-sector

6 https://www.adb.org/publications/2019-trade-finance-gaps-jobs-survey

7 https://www.atlanticcouncil.org/in-depth-research-reports/issue-brief/belt-and-road-in-latin-america-a-regional-game-changer/

8 https://www.adb.org/sites/default/files/publication/521096/adb-brief-113-2019-trade-finance-survey.pdf

solutions were viewed equally as the most effective: regulatory revision and technology.

With compliance constraints a key contributor to trade finance rejections, it is unsurprising that revising existing regulatory requirements was identified as one of the best ways to close the gap. If revisions that create an optimized compliance landscape for all parties are to occur, however, greater collaboration, cooperation and understanding between regulators and banks will be required. According to the survey, the role of banks was deemed particularly important in driving and establishing regulatory change – considerably more so than that of industry bodies, corporates and small to medium enterprises (SME)s.

With respect to technology, sharing data through centralized KYC databases is viewed as having the most value, with 71% selecting this – or the Legal Entity Identifier (LEI) in particular – as the top technology option to address compliance-related issues. Such data pools, which would be accessible by trusted user groups, could reduce the duplication of due diligence processes by multiple banks, thereby streamlining KYC and helping to reduce costs.

Interesting to note is that technology was also ranked the least important way to narrow the gap by nearly a third of participants in the BNY Mellon survey, mentioned above. This suggests a possible lack of confidence by some in technology's ability to deliver significant results, or that further education may be required. Indeed, with 37% of bank respondents in the 2018 ICC Global Trade Finance Survey stating that implementing technology to enhance trade finance was not currently on their agenda[9], a greater understanding of these technologies and their capabilities is needed if technology is to drive meaningful change.

Alongside technology and regulatory revision, the ongoing importance of correspondent banking partnerships was reflected throughout BNY Mellon's survey. For example, risk sharing partnerships with global banks was ranked highest for creating additional financing capacity, while participants acknowledged the value of correspondent banks in particular in educating local banks and lobbying government trade bodies regarding the benefits of trade finance solutions. Certainly, local-global bank partnerships continue to be regarded as vital in helping to facilitate global trade.

### Taking action

What is clear is that banks – and collaboration – have a key part to play in driving results when it comes to closing the gap, be that through regulatory change, technology innovation, correspondent banking – or a combination of solutions. And what is essential is that we work together to decide upon and implement the best course of action to help ensure we can most effectively and efficiently address the gap. By directing our efforts on solutions judged to have the most value, it is most likely that the network effect – support from across the finance community – can be achieved, enabling the industry to maximize the benefits of those solutions, and drive enhanced trade finance support and accessibility for underserved businesses.

For example, our survey indicates a significant degree of consensus regarding the benefits of centralized KYC databases. With the value of such systems seemingly established, creating a clear, focused approach to developing their potential could help to ensure they can be successfully implemented, and fully utilized to support global trade.

The trade finance gap is an issue affecting companies within Latin America and beyond. If the region is to realize its potential for growth and optimize its growing trade partnerships with Asia, banks – and the wider industry – need to come together and deliver a solution. And with the gap potentially growing, this is all the more pressing. Addressing the trade finance gap is undoubtedly a challenge, but if it is allowed to persist, it stands to have severe implications for trade and the health of the world economy. The time for the industry to align, unite and act is now.

**To learn more about BNY Mellon's Trade Processing Services Click Here**

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9 https://iccwbo.org/publication/global-survey-2018-securing-future-growth/

# Getting Ready for the ISO 20022 Revolution

**By Isabel Schmidt**

The cross-border payments industry has been relatively stable for a number of decades, with the last significant overhauls being the creation of SWIFT in 1973 and launch of the messaging service in 1977. Now, banks are preparing for a new wave of change, with the upcoming transition to ISO 20022.

ISO 20022 is a completely new messaging format that will replace existing infrastructure (such as MT messages), which is unable to support the depth and structure of information needed to meet today's cross-border payment needs. ISO 20022 (also referred to as MX messages) will use an XML-based system, which has many fields, thereby enabling messages to be more robust, structured and comprehensive in the amount of data they hold. With MX messages so different to legacy formats, banks will need to ensure their systems can cope with the larger set of data with respect to storage, capacity and performance.

The ISO migration is taking place in various stages over the next five years, with differing timelines for different jurisdictions. For USD systems, for example, the Federal Reserve Bank is expected to publish its revised timeline during Q2 2020 for Fedwire, with experts not expecting the target migration date to materially change from the initial proposed deadline of late 2023.

The euro clearing system (including TARGET2 and EBA Clearing) will be the first to switch to the ISO format, with a deadline of November 2021. SWIFT also intends to enable its ISO messaging at this time, with any bank – not just European banks – that is connected to the SWIFT network required to be able to receive ISO messages.

### ISO20022 Timeline

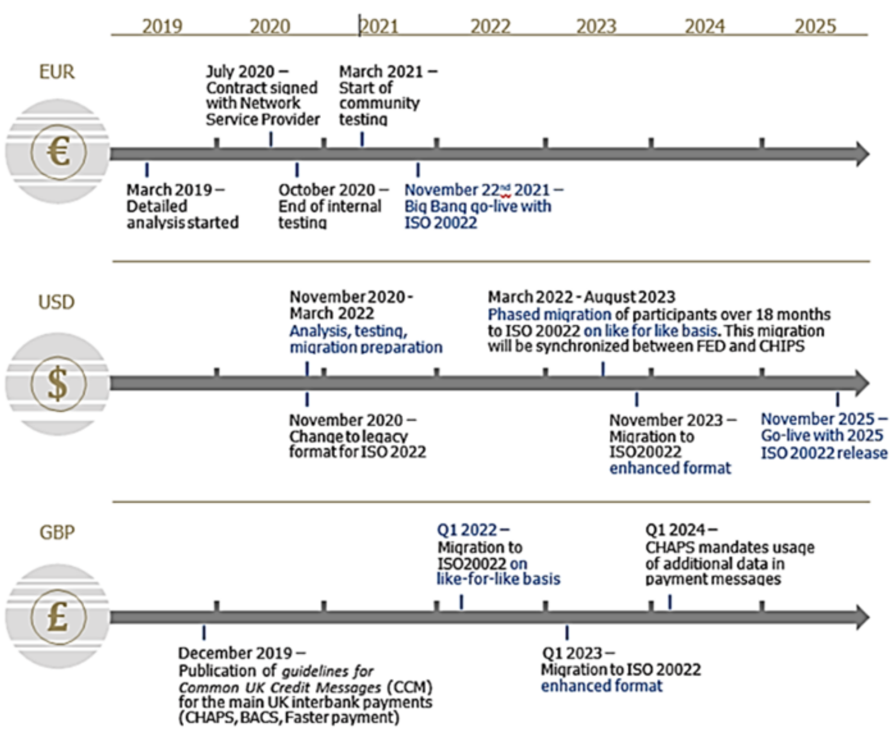


*Figure 1: High-level timeline for EUR, USD, GBP*

In Latin America, banks are aware of the benefits that ISO 20022 can provide. SWIFT has been actively involved in the region with educational activities such as their LATAM Regional Conference in Panama in 2019. Regional banks seem to be taking the approach that this is an evolving solution and not one that needs to be addressed all at once. Nevertheless, conversion to ISO 20022 will be necessary in the long run if banks are to stay abreast of customer demand and rate of adoption may be dictated by what occurs elsewhere in the world.

### November 2021: an important date for banks across the globe

While it may initially seem that the November 2021 deadline will have minimal impact for non-European banks, this is not the case. The coexistence phase – when some banks will be using ISO and some using legacy messaging formats – will create significant challenges, and any bank in any part of the world will potentially be affected. This is because some European banks will likely use the November 2021 deadline to undertake a blanket migration of all their currencies, not just euros – particularly as many banks use one platform for all high-value currency payments.

During this time, payments could be originated in ISO by a fully ISO-ready bank, but then have to be cleared through a market infrastructure that has not yet migrated. Banks in jurisdictions that have not yet updated their infrastructure, including banks across Latin America, could therefore be receiving far more data than they can easily pass on, as there is no straightforward mechanism for banks to translate ISO information into legacy formats. For intermediary banks, who are expected to transfer information along the chain, they will need to evaluate what they pass on and how.

But any bank that receives ISO data will need to think carefully about how they deal with it. It might need to be sent to the client, for example, or fed into sanctions and transaction monitoring systems as part of regulatory requirements. Banks should therefore correspond with their local regulators to understand what their expectations will be.

## The ISO journey

In planning for the upcoming changes, it is important that banks are aware that the ISO transition will impact the entire payments lifecycle. Any system that is part of the payments and settlements process – payments systems, messaging systems, reporting systems – will potentially be affected as it will need to be able to receive and transmit the additional, structured information.

Furthermore, the impacts will be felt far beyond payments operations and cash management. Every business line, at some point, is likely to make a payment. Each individual bank will therefore need to carefully consider which business components could be touched and plan accordingly. They will need to evaluate how their systems operate, and introduce upgrades where needed to ensure existing procedures and services can continue to operate effectively.

As well as the technology element, education is a critical part of the process for banks in effecting a smooth transition. This applies to both internal stakeholders – ensuring they are thoroughly informed of the changes and what is required – and clients. Indeed, there is potential technical work for end clients to undertake, and banks have a key role to play in making sure they are prepared.

For instance, having comprehensive, quality data is fundamental for ISO and for driving optimized upfront validation, and banks will need to consider whether clients have the information needed for ISO messages, and whether it is structured correctly. In the case of an address, whereas MT messages have a broad, unstructured field, MX messages specify where various components of an address should be written, breaking it down into “building number,” “building name,” “street” and so on. Does the end client have this level of detail and can they input it correctly?

Elsewhere, any templates that have been established for regular payments will need to be updated from legacy formats in line with ISO format requirements.

The degree to which such tasks are carried out by banks or passed to clients is a question each bank should address. They will need to ensure the transition is as seamless as possible for clients, assessing how they can support and add value – including providing any tools that can be created to help them make the changes – and ultimately delivering the enhanced user experience that will be possible when ISO is realized.

## Reaping the rewards

ISO will introduce a host of benefits, with richer data meaning better data analytics and, in turn, added value for clients, as well as greater automation of payment processes, with the potential to not only enhance speed and efficiency, but to also help facilitate the path to 100% STP rates, reducing manual intervention and cost. Over time, it will result in fewer false positives, thereby enabling more effective risk management. Beneficiaries will also be able to use the enhanced data to help them undertake automatic reconciliation, thereby benefiting cash flow and counterparty risk management.

This is a chance for banks to deliver an improved end-to-end payments experience for clients. Getting there may not be easy, and there is no fixed blueprint for all, but by being fully apprised of the changes and what is expected, and through careful, thorough planning and strategy implementation, banks can successfully make the transition from MT to MX – the next generation of payments – and truly optimize cross-border transactions for them and their clients.

## Additional Resources

**T2/T2S Consolidation**
https://www.ecb.europa.eu/paym/pdf/consultations/Business_Description_Document_v1.0.pdf

**USD**
https://www.frbservices.org/resources/financial-services/wires/iso-20022-implementation-center.html
https://www.theclearinghouse.org/advocacy/articles/2018/09/comment_letter_iso_20022_fedwire_09-04-2018

**GBP**
https://www.bankofengland.co.uk/payment-and-settlement/rtgs-renewal-programme/consultation-on-a-new-messaging-standard-for-uk-payments-iso20022

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## Celebrating Our Long-standing Client Relationships in Latin America

**By Dino Sani, Jr.**

Started by Alexander Hamilton in 1784 as The Bank of New York, BNY Mellon is one of the longest-lasting financial institutions in the world. We have endured, innovated and prospered through every economic event and market move over the past 230 years.

In Latin America, BNY Mellon has been conducting business since the 1890s. Our story in the region began in 1893, when The Bank of New York became the agent for the British Bank of South America, which had a number of branches across the region. The Company then opened offices in Buenos Aires in 1970, the Cayman Islands in 1973, in Miami to serve Latin America clients in 1981, and a Representative Office in Mexico City in 1994.

In 2007, The Bank of New York Company, Inc. merged with Mellon Financial Corporation to create the world's largest securities servicing provider and a top asset management firm globally, making the two legendary institutions a winning team as BNY Mellon. (In parallel with Bank of New York, Mellon Financial Corporation formed a relationship with The Bank of London in South America in 1965, and later opened offices in Santiago and Rio de Janeiro.)

Today, we offer a full range of asset servicing solutions, depositary receipts, treasury services, corporate trust, collateral services, and asset management for the Latin market. With representative offices in Mexico, Chile and Argentina, as well as significant local operations and a banking license in Brazil, the Company offers a full range of financial services to the Latin market.

Given the above, some of our client relationships go back a very long time, far longer than I've been alive in some cases. I feel both proud of this – proud of the continuous quality of our work that has made this possible – and very grateful for the loyalty shown us, and by the personal friendships that I have acquired and shared in the process. We honored these long-term relationships at Felaban in 2018 and in 2019 and would like to mention them again here.

Below are the names of our most long-standing clients and the durations of those relationships.

- BNC Haiti, 73 years
- Banco De Chile, 73 years
- BBVA Uruguay, 74 years
- Banco Atlantida, 74 years
- Scotiabank Peru, 76 years
- Banco Itau Corpbanca Colombia S.A., 77 years
- Banco Patagonia, 80 years
- Interbank, 85 years
- Banco De Mexico, 85 years
- BBVA Bancomer, 86 years
- Banco do Brasil, 90 years
- Banco de la Provincia de Buenos Aires, 94 years
- Banco de Costa Rica, 94 years
- Banco de Galicia, 96 years
- BBVA Frances, 99 years
- Banco de Crédito del Perú, a client of BNY Mellon for 104 years!

These are truly historic partnerships.

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March 2020