Fintech and Cross-Border Payments

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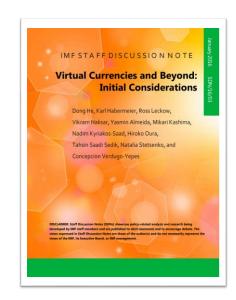
Gaborone, Botswana, July 9, 2018

This presentation represents only my personal views



Selected IMF Analytical Work on Fintech

- Staff Discussion Note "Virtual Currencies and Beyond: Initial Considerations" (January 2016)
- Staff Discussion Note "Fintech and Financial Services: Initial Considerations" (June 2017)
- Speech by Managing Director Christine Lagarde "Central Banking and Fintech—A Brave New World", September 29, 2017
- April 2018 Global Financial Stability Report (GFSR)
- □ June 2018, *Finance & Development* "Money, Transformed"

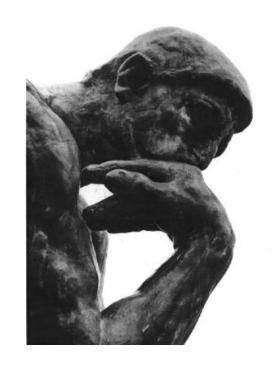






Questions to address

- What are the longer terms consequences of current acceleration of technological innovations?
- Why is the cross-border payment landscape ripe for change?
- In which ways fintech can be used to improve the efficiency of cross-border payments?
- Why central bank digital currencies would have an edge over crypto assets for making cross-border payments?





Simple framework focuses the analysis

What impact might Fintech have on the financial sector, and how should regulation respond?



Technology can affect market structure

Need for intermediaries

- Information asymmetry
- Matching
- Transaction costs

Technological innovations



Horizontal & vertical integration

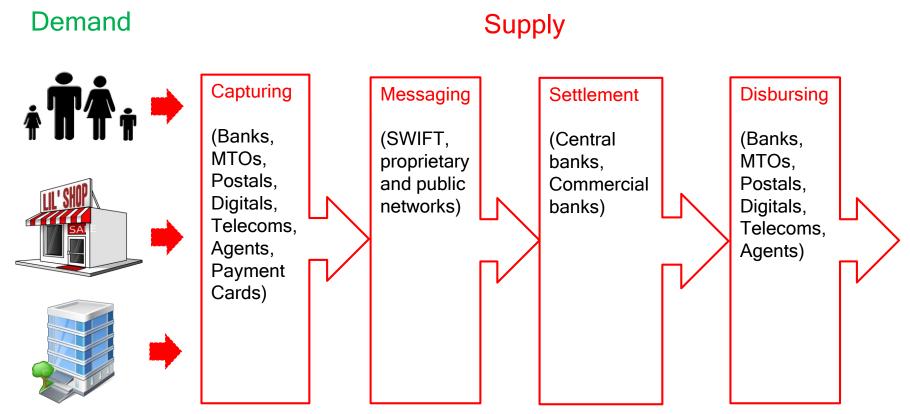
Customer information

Barriers to entry

- Scale (fixed)
- Sunk costs (trust, distribution)
- Network externalities



Ripe opportunities to improve cross-border payment chain



The whole process could take between 3 to 5 days.

Shortcomings: costly, cumbersome, slow, and opaque



Evolving landscape for cross-border payments

Current

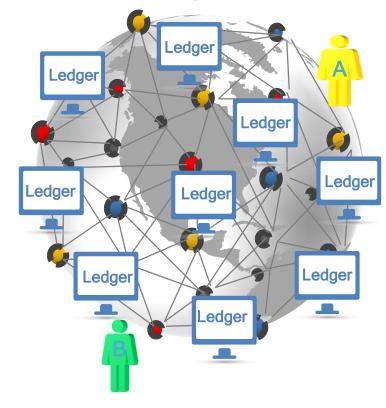
Account-based

Country A Country B Central Bank Central Bank Domestic **Domestic Payment System Payment System Bank** Bank **Bank Bank** Nonbank Nonbank Nonbank Nonbank **Payee Payor**

Route 1: Correspondent Banking Route 2: Payment System Link

Future?

New networks and means of payments



- ✓ Choice of account-based and token-based systems
- ✓ Less reliance on correspondent banks



How could Fintech reshape the landscape?

Three DLT-based scenarios



2

3

Back-end processes

 Efficiency gains from payments tracking, accounts reconciliation, and liquidity optimization

Small impact (barriers in correspondent banking)

Compliance

- Large savings from compliance costs with information sharing (KYC utilities and digital identities)
- Some impact with new entrants

Means of payment

- (i) New networks enable faster, traceable, and low-cost payments, and (ii) CBDCs bring trust, more stable FX rates, and interoperability
- Significant impact

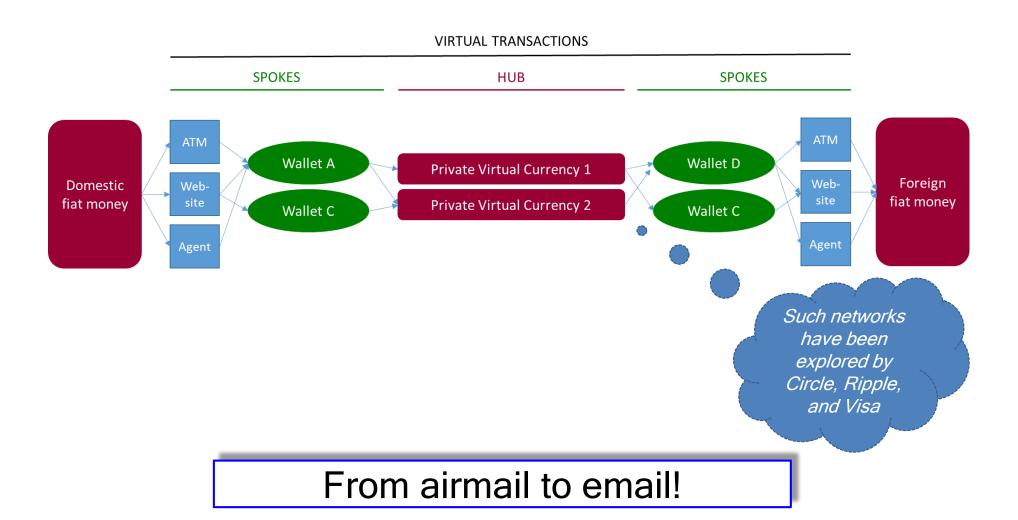
Market structure

attributes

Potential disruption



New global networks using virtual currencies





Caveats for using cryptos as bridge currencies

- Erratic valuation introduces risks and could limit adoption at least for large value payments
- Lack of *trust* could erode the value of crypto assets, though regulation could help
- Lack of interoperability among networks could keep prices high





A central bank digital currency?

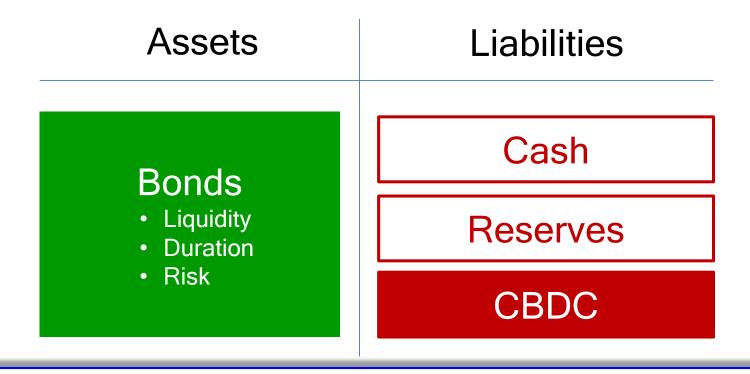








A token issued by the central bank



- Digital form of money
- Exchanged at par with other liabilities
- Based on cryptography (& distributed ledger)

- Decentralized
- Peer to peer
- Interest bearing?





Why?

Efficiency

- Competition from cryptos
- Cost/Inclusion
- Inter-operability
- Network effects

Monetary policy

- Maintenance of seigniorage
- Enhanced transmission

Risks

some of which can be contained

- Illicit activity... but anonymity a continuum
- Operational risks
- Disintermediation
- Run risks?



Concluding remarks

- □ Fintech applications are likely to alter the organization of financial services in the medium term.
- Central banks and regulators need to foster innovation without undermining stability and trust.
- Cross-border payments are ripe for change.
- □ Cash-on-ledger and CBDCs are potential game changers
- International cooperation is essential.







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