ISO 20022: A New Era for Payments

The migration to ISO 20022, the new payment messaging standard, is set to have a profound effect on payments. Challenges lie in wait for many banks and their clients, who will have to invest significant resources to cope with the upcoming change. Yet crucially, these efforts will not go unrewarded. Marcus Sehr, Head of BNY Mellon Treasury Services, Europe, and Isabel Schmidt, Global Head of Direct Clearing and Asset Account Services, BNY Mellon Treasury Services, explain.

During the next five years, ISO 20022 is set to transform the payments industry. The migration will touch the payment lifecycle end-to-end and, as the implementation deadlines draw near, the implications and considerations are set to be far-reaching—requiring significant efforts and resources from banks and their clients. But, while many within the industry might be familiar with the term ISO, many remain unaware of the changes that await them.

So what exactly is happening? ISO 20022 will gradually replace SWIFT MT messages as the standard messaging format for the transfer of cross-border and high-value payments—bringing with it more structured, robust and comprehensive data. The migration is taking place in various stages, beginning first with the euro clearing system in November 2021, including TARGET2 and EBA Clearing. By that time, any bank that pays or receives euro transactions through the European clearing system will therefore need to be able to both send and receive ISO payments. The original November 2021 timeline for the migration of the SWIFT network to ISO was recently pushed out by a year to the fall of 2022.

While other jurisdictions are yet to fully confirm their timelines, industry experts expect the Bank of England's deadline, for example, will follow in early 2022, with the U.S. Market Infrastructures expected by late 2023.

The upcoming changes should not be underestimated. In the leadup to and aftermath of the transition, banks will face a myriad of challenges. If they can overcome these hurdles—by establishing a clear, comprehensive strategy, educating and supporting their staff and clients, and preparing their systems—they have an opportunity to deliver a truly improved end-to-end payments experience for clients.

RICHER DATA

Used by legacy clearing systems established as far back as 40 years ago, MT messages and their equivalents—the incumbent payment messaging standard—lack the depth of information required to meet today's cross-border payment needs. Therefore, to keep pace with evolving client requirements and technological advancements, the standard is changing to enable transactions to be optimised, with ISO setting the foundation for the future of payments.

ISO messages (otherwise known as MX messages) are based on XML (Extensible Mark-up Language), a text-based format that, when compared to MT messages, contains many more data fields. For example, under ISO, the comparable equivalent to a half-page MT103 message will take up multiple pages. ISO also fundamentally changes the language associated with cross-border payments. Those referred to as "originators" or "ordering parties" today will be called "debtors"; "beneficiaries" will be called "creditors"; and the parties along the chain will also have different terminologies.

As a result, the size, amount and type of data transferred across the payment chain will be vastly different. While this will unlock a host of benefits for banks in the long-term, ensuring their staff can understand the additional complexities and that their systems can handle the more granular data will prove a significant challenge.

What's more, receiving and transmitting the additional information means that any system within a bank that touches a payment could be affected. As a result, they will need to engage in an in-depth review of each of their systems. As part of ongoing digitalization efforts, many banks may have already incorporated systems that can cope with the richer data. The incoming challenge, however, will be most acute for banks that continue to operate on legacy systems that have little to no provision for ISO messages. To ensure their existing products and services continue to perform effectively, these banks will need to decide between fully upgrading their legacy platforms or building transitional models or insulation layers.

THE COEXISTENCE CONUNDRUM

Another challenge that banks will need to navigate results from the fact that the fragmented migration approach necessitates a coexistence phase, during which some banks will begin to use ISO while others will continue to use legacy messaging formats.

This creates a number of complexities. This is because some European banks are likely to use the November 2022 deadline to migrate cross-border payments for all their currencies —not just euros—as many banks use a single platform for all high-value payments and will at that point be able to eliminate the complexity of handling multiple formats. As such, a payment might be originated in ISO but cleared through a market infrastructure that is not yet ISO-ready. This will impact not just those in Europe, but all parties in a payment chain who will have to deal with receiving differing amounts and types of information through a variety of channels and, in some cases, with excess data forwarded separately from the main payment information.

Crucially, stakeholders will likely not be able to ignore the additional information contained in ISO messages—even if they themselves are not yet migrated. Intermediary institutions are expected to uphold the integrity of the information they receive, while each individual bank will also need to assess whether the information needs to be sent to the client, as well as what needs to be done from a regulatory perspective. The upcoming migration should, therefore, not be underestimated.

SCALE AND SCOPE

The scale of the task at hand for the payments industry is enormous. The areas of the business affected goes much further than just payments operations and cash management—potentially extending to all business lines that make payments. Depending on the structure of individual banks, this could make the move to ISO enterprise-wide.

For the affected business lines that sit outside of payments, performing the necessary impact assessments, obtaining stakeholder support and securing funding can be challenging. In such cases, knowing which stakeholders to involve in the migration strategy, be they product managers, customer services or enterprise risk teams, can prove difficult and could demand a more collaborative, multi-disciplinary approach.

Furthermore, while much of the migration's focus is on the transformation of payment messages, ISO is also being extended to advice and statements. This means that demand deposit accounts (DDA) and reporting systems, as well as nostro reconciliation platforms, could be affected. Banks will also need to consider ancillary data translation services for the current MT FIN equivalents, as well as global client access functions that transmit statements and reporting.

What's more, it is not just banks that will feel the effects—end clients will also have to prepare for ISO messages. Banks will be required to educate and support their clients in this endeavour, ensuring that they have the required information in the correct format and structure. As part of their ISO strategy, banks will need to decide what work they will undertake in this respect and what work needs to be done by the client, and find the right balance during the transition process: creating an enhanced ISO user experience, and making the preparation manageable for clients.

PREPARATION ROADMAP

Banks should not underestimate the time it will take to prepare for ISO and should work to implement a transition roadmap accordingly.

It is important that all take note of the scale of the task ahead, from a technology, client support, compliance, operational risk and business strategy perspective. Equally, everyone who plays a role in the payment chain—be it those in operations, customer service, payments compliance or cash management sales—needs to understand the complexities of the new transformation.

But education is just the beginning. Banks should then look to establish a dedicated, cross-discipline team to capture the front-to-back impact of the transition. From here, strategic decisions will need to be made for clients, striking the right balance between adding value and making the transition as seamless as possible. In tandem, banks should be in a constant dialogue with their market infrastructures and should work alongside SWIFT. SWIFT is working to provide banks with the training and tools necessary for the migration, such as the Readiness Portal and MyStandards tool that have been launched to make it easier to carry out testing and validate messages.

Of course, there is no catch-all blueprint for banks to follow. The upcoming changes must be assessed on an individual basis and the preparations chosen will depend on a bank's technical capability, their role, their business scenarios and priorities, as well as local regulatory requirements.

A NEW ERA

Though ISO undoubtably brings a host of challenges, it will also herald a new era for payments—and one that will deliver considerable benefits to banks and their clients. The richer, more structured data will improve straight-through-processing (STP), enhance speed and drive efficiency—all while reducing manual intervention and cost. Eventually, ISO, in combination with other industry initiatives, could potentially even clear a path to end-to-end 100% STP rates.

For beneficiaries, the richer data contained in ISO messages will allow them to undertake automatic reconciliation, which will benefit cash flow, counterparty risk management and even help deliver against their own client experience goals.

For banks themselves, the enriched data provision will bring greater automation—reducing friction in the payment processing flow. Over time, this will result in fewer false positives in risk management systems, allowing for more focused, effective risk management and the optimization of resources. Payment risk modelling and scoring will also see benefits—with the ISO format allowing banks to offer enhanced data analytics to their clients.

The full extent of ISO benefits will, however, only be fully unlocked when critical mass has been achieved. The developments that follow could then be even more transformational. A key priority for cross-border payments is to make them real-time. If the combined powers of ISO and SWIFT gpi, which is already enhancing the efficiency and client experience in cross-border payments, can be realized, this long desired goal could be achieved.

The views expressed herein are those of the authors only and may not reflect the views of BNY Mellon. This does not constitute Treasury Services advice, or any other business or legal advice, and it should not be relied upon as such.

This article first appeared in Global Banking & Finance Review, April 6, 2020.

Consider Everything

BNY MELLON