Payment matters - July 2024

Upcoming global developments for the payment sector

July 22, 2024

Global

Payment sector on the horizon: What do I need to know?

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Asia

— Hong Kong: HKMA and Banque de France to collaborate on wholesale CBDC

On 27 June 2024, the Hong Kong Monetary Authority (HKMA) and the Banque de France (BDF) announced that they are working together on wholesale central bank digital currency (CBDC) initiatives. Together, the regulators will explore different cross-border payment solutions and use cases, with the aim of enhancing financial market connectivity and advancing the growth of the global tokenisation market.

The HKMA and the BDF will examine how well their wholesale CBDC systems (BDF's DL3S and HKMA's Project Ensemble Sandbox) work together. They will focus on instant international and multi-currency payments and find ways to make settlements more efficient and compatible across different regions' financial systems.

The two regulatory bodies have also recently signed a memorandum of understanding to promote innovation in the wholesale CBDC and tokenisation market. They commit to improve communication and collaboration in this space.

Impact: HKMA representatives highlighted the significant potential for France and Hong Kong to collaborate, especially in fintech. Both BDF and HKMA are recognised as CBDC pioneers. It is expected that both bodies will continue to "explore cross-border payment solutions and use cases, to promote financial market connectivity", pushing forward the development of the global tokenisation market.

— Singapore: Expansion of initiatives to scale asset tokenisation

On 27 June 2024, the Monetary Authority of Singapore (MAS) announced the next stage of Project Guardian, a project that involves working with global industry associations and financial entities to set universal standards for asset tokenisation in fixed income, foreign exchange, and asset and wealth management.

The project will now include more industry associations like the Global Financial Markets Association, the International Capital Market Association and the International Swaps and Derivatives Association in three workstreams: fixed income, FX, and asset and wealth management.

After its completion of the first phase of the Global Layer One (GL1) initiative, MAS now plans to collaborate with international policymakers like the European Central Bank, Banque de France, and the International Monetary Authority to form a non-profit, GL1 Org. This non-profit organisation will develop common principles, policies, and standards for operating a global shared ledger infrastructure.

Impact: This development represents an advancement in the asset tokenisation space within Singapore. The GL1 initiative represents a step forward to unlock the benefits of asset tokenisation and improve capital market efficiency. We expect continued collaborations between public and private sectors as these are important to make sure that financial systems continue to benefit market players and consumers while preserving market integrity and stability.

Europe

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— Digital euro: ECB releases first progress report

On 24 June 2024, and as part of the preparation phase, the European Central Bank (ECB) released its first progress report on the digital euro project which began on 1 November 2023. The project forms part of the ECB's aim to launch a European central bank digital currency. The report sets out the project's developments and future plans before the ECB issues the digital euro.

Among other things, the ECB:

- **Has agreed on technical features to ensure that online digital euro transactions will offer higher privacy standards than current digital payment solutions, while still providing robust protection against fraud;**
- **Is developing an offline function that would allow digital euro users to make payments without an internet connection. The ECB has been exploring technical tools that could enable the settlement of offline digital euro transactions directly on users' devices;**
- **Plans to create a rulebook which will contain a single set of rules, standards, and procedures to standardise digital euro payments – it will be developed by the Rulebook Development Group made up of representatives including consumers, retailers and Eurosystem central banks; and**
- **Issued five calls for applications (now closed) to set up framework agreements with providers for the provision of digital euro components and related services.**

Impact: The first draft of the rulebook is expected to be delivered by the end of 2024. The ECB's preparation phase for the digital euro is set to extend until late 2025, at which point a decision will be made on whether to proceed with the plans. The ECB will only decide to issue the digital euro once the relevant legislation has been adopted.

— Respond to the consultation on AI's role in finance

On 18 June 2024, the European Commission (EC) launched a consultation on AI's role and impact in the finance sector. Feedback is requested from stakeholders on AI's development in financial services, specific AI use cases in finance, and the EU AI Act's implementation, especially for high-risk cases.

The EC also issued a series of workshops to seek input from stakeholders. These will be jointly hosted with the European Supervisory Authorities and national supervisors. They will enable stakeholders to showcase projects and discuss recent advancements.

Impact: Comments on the consultation close on 13 September 2024 – share your experiences and perspectives to inform the EC's approach to AI governance in financial services. Views are particularly welcome from companies that already provide or develop AI systems. The registration for workshop series is open until 26 July 2024. The EC will subsequently release a report on AI trends in finance. Read our briefing for more information.

Global

— Basel Committee consultation on principles for management of third-party risk

On 9 July 2024, the Basel Committee on Banking Supervision (BCBS) published a consultation proposing principles for the sound management of third-party risk in the banking sector. The BCBS recognises that digitalisation has led to new innovative approaches in the banking sector, meaning that banks have increased their reliance on third parties beyond the scope of traditional outsourcing.

To deal with this, the consultation paper sets out twelve principles guiding banks and supervisors on managing risks from third-party arrangements – by doing so, the BCBS seeks to promote a principles-based approach to improving banks' operational risk management and operational resilience through effective third-party risk management.

Impact: Comments on the proposed principles are open until 9 October 2024. These Principles, mainly for large banks and their supervisors, also benefit smaller banks and authorities globally. They set a common standard for managing third-party risks, allowing flexibility for changing practices and regulations. They remain technology-neutral, making them applicable to various technologies, including AI, machine learning, and blockchain.

— BIS and partners complete phase three of Project Nexus

On 1 July 2024, the Bank for International Settlements (BIS) and partners announced completion of phase three of Project Nexus (Project).

The Project's goal is to improve international payments by linking different countries' instant payment systems (IPS) – it aims to standardise how IPS connect to each other. Instead of each IPS operator building custom connections for each new country, they only need to connect to the Project. This single connection lets the IPS reach all other countries in the network.

BIS will help central banks and IPS operators from India, Malaysia, the Philippines, Singapore, and Thailand as they prepare for phase four of the Project. The Bank of Indonesia will be a special observer.

Among other things, the phase three report outlines:

- **The governance, scheme, and oversight arrangements for the Project that balance regulatory differences across countries while maintaining risk management, safety, efficiency, and resilience.**
- **The Project's business and revenue model, designed for financial self-sustainability and to motivate key industry participants to join.**
- **The technology architecture and operational model of the Project, which builds on**

the software insights from the 2022 proof of concept.

In phase four, Bank Negara Malaysia, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, Bank of Thailand, and domestic IPS operators will be joined by the Reserve Bank of India.

Impact: Completion of phase three reflects good progress being made on the implementation of cross-border payment infrastructure to enable improved and efficient global payment connectivity. The scheme is expected to launch by 2026.

UK

— New PSR policy statement related to APP scams reimbursement requirement

On 12 July 2024, the Payment Systems Regulator (PSR) issued a policy statement on compliance and monitoring under the Faster Payments Systems (FPS) authorised push payment (APP) scams reimbursement requirement.

The policy statement confirms:

- **The requirement for PSPs to register with Pay.UK by 20 August 2024. Part of the reason for this requirement is to help to facilitate a shared directory (the FPS Reimbursement Directory). The directory will allow PSPs to find each other's contact details so that they can communicate in relation to APP scam claims and meet the requirements in the FPS reimbursement rules and the PSR's policy.**
- **The monthly reporting requirements for in-scope sending PSPs, so that Pay.UK can effectively monitor compliance with the FPS reimbursement rules.**
- **The limits the PSR is placing on Pay.UK regarding the use and disclosure of compliance data.**
- **The PSR's approach to requiring PSPs to inform consumers of their rights, including the obligation to update terms and conditions. In particular, the PSR is (i) requiring directed PSPs which are capable of being a sending PSP to amend their terms and conditions by 9 April 2025 to include a provision that they will reimburse customers in line with the reimbursement requirements and rules; and (ii) requiring PSPs to notify customers of their rights and of the upcoming contractual changes by 7 October 2024.**

These changes will be delivered via legal instruments SD19 and SD20 (including the compliance data reporting standards) and SR1.

Impact: The requirement to send out a communication to notify customers of their rights and to update terms and conditions will have a significant impact on firms. Firms will need to move swiftly making a plan for the content and method of delivery for these communications, taking into account the requirements of the Consumer Duty. The PSR is going to publish further information this month which they say will support PSPs relating to the communications which need to go out.

— Preparing for the upcoming CHAPS APP scam reimbursement requirement

On 8 May 2024, the PSR published a consultation (now closed) on its proposed specific direction for CHAPS participants to refund victims of APP fraud. At the same time, the Bank of England (BoE) (the operator of CHAPS) released its draft CHAPS reimbursement rules. The specific direction will make it compulsory for PSPs to follow the BoE's rules and provide data to the BoE.

The intention of the new requirements is to mirror the protections set to be afforded to victims of APP scams who lose money via the Faster Payments System (FPS) and to provide consistent processes for firms across both payment systems. Another intention is to incentivise firms to prevent fraud across payment systems, in turn preventing criminals switching from using FPS to CHAPS to perpetrate fraud.

The CHAPS reimbursement requirement will apply to the same PSPs as the FPS requirement (which excludes credit unions, municipal banks, and national savings banks).

Impact: The PSR will publish the specific direction on CHAPS in September this year, with implementation on 7 October 2024. Firms will need to move very quickly interpreting and implementing the requirements over the summer, given the short timeframes for implementation.

US

— Comments requested on use of AI in the finance sector

On 17 June 2024, the US Department of the Treasury (Treasury) released a request for information (RFI) on AI's use in finance, its opportunities, risks and impact on stakeholders.

Through the RFI, the Treasury would like to understand the potential barriers to AI's responsible use within the financial services sector, the effects on stakeholders (such as consumers, investors, businesses, and regulators) and suggestions for improving AI-related legislative, regulatory, and supervisory frameworks.

The Treasury is looking for insights into AI uses, including but not limited to, financial institutions' use of AI to:

— Assist in decisions related to offering financial products or services;

— Manage various types of risk, including credit risk, market risk, operational risk, cyber risk, fraud and illicit finance risk;

- **Assist in capital markets activities, including identifying investment opportunities, allocating capital, executing trades, and providing financial advisory services; and**
- **Manage internal operations, such as payroll, HR functions, training, and performance management.**

The RFI indicates that the Treasury endorses responsible innovation and competition in finance. It aims to foster a financial system that provides fair and inclusive access to services, caters to stakeholder needs, ensures stability and integrity, safeguards vital infrastructure, and fights against illicit finance and threats to national security.

Impact: Comments are due by 12 August 2024. Feedback is requested from financial institutions (such as banks, credit unions, insurance companies, non-bank financial companies, asset managers, broker-dealers, and any other company that facilitates or provides financial products or services).

Written by Kirath Bharya, supported by Jonathan Botham (Knowledge).

Further resources

- UK Retail Finance Horizon Scanner - June 2024
- The future of Financial Services - Decoding AI: Episode 7
- ESMA Call for Evidence on UCITS Eligible Assets Directive
- AIFMD II – evolving requirements applicable to loan originating AIFs

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Key contacts

EVERSHEDS
SUTHERLAND

Richard Jones

Partner

United Kingdom

Hannah C. Winiarski

Special Counsel

Chicago, United States of America | Atlanta, United States

EVERSHEDS
SUTHERLAND

Brian M. Murphy

Partner

Atlanta, United States

Rhys McWhirter

Partner

Hong Kong SAR, Asia

EVERSHEDS
SUTHERLAND

Trevor Dolan

Partner

Dublin, Ireland

Frankie Tam

Partner

Hong Kong SAR, Asia

EVERSHEDS
SUTHERLAND

Rachel M. Reid

Partner

Atlanta, United States

→

Ruth Fairhurst

Legal Director

United Kingdom

→

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