Cross-currency payments can yield new revenue streams

While traditionally viewed as a nuisance, lower-value cross-currency payments could yield new revenue streams for financial institutions, says Timothy Merrell, Head of FX4Cash, at Deutsche Bank

Today's payments environment is becoming increasingly competitive and – thanks to price compression and regulatory initiatives such as the Single Euro Payments Area (SEPA) and Payments Services Directive (PSD) – many banks are facing decreasing revenues. Indeed, cross-currency transactions can present additional problems for financial institutions as they are made up of two components, often treated separately: the payment element and the foreign exchange element.

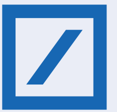
In terms of the payments element of such a transaction, much of the infrastructure used for processing is hosted on technology that is several decades old and has generally suffered from a lack of investment over the years. And with volumes continuing to increase, as well as the changes associated with new technology and regulatory standards, this infrastructure is coming under increased strain. Indeed, the possibility of the failure of these systems presents a significant operational risk for many institutions.

The foreign currency element of a transaction can add further problems. Payments with a foreign exchange element are estimated to have a wallet of over $12 billion annually with cross-border transactions representing approproximately 8% of the total payments. It's therefore interesting that these types of payments are not traditionally considered to be profitable by most banks and financial institutions.

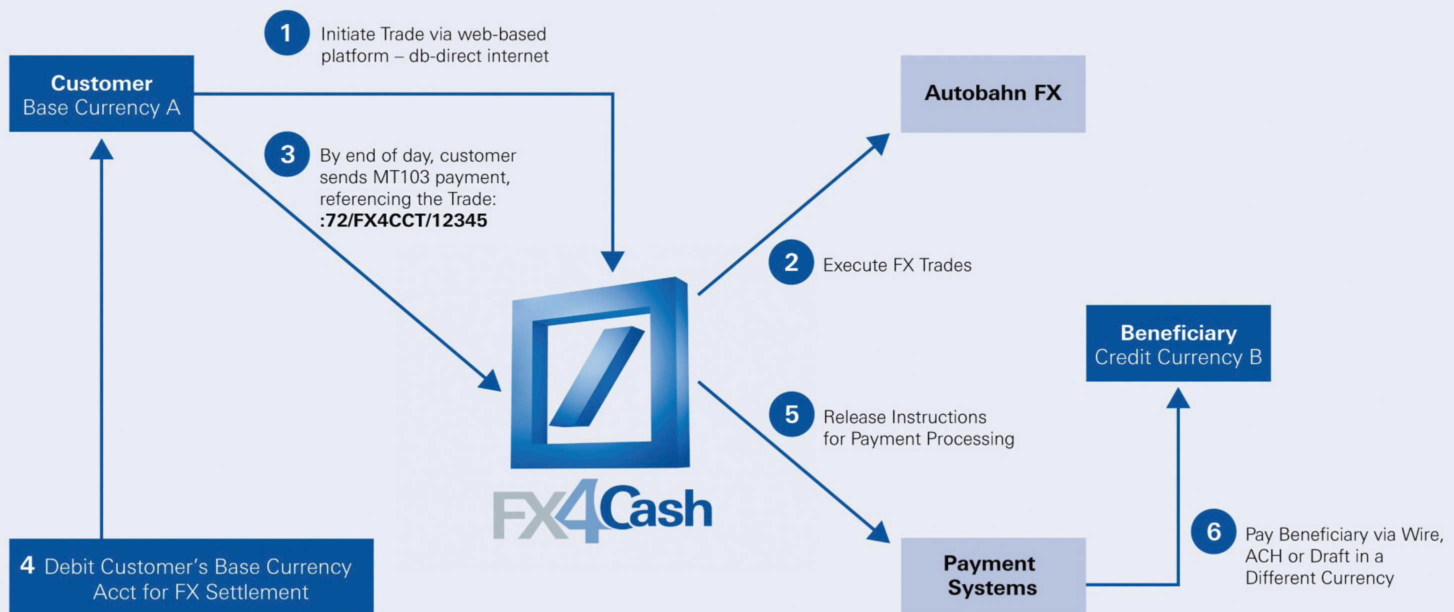
Indeed, these transactions have often been seen as costly for the instigating institution in terms of both time and expense. Despite the expense, there will be a range of reasons why institutions are processing high volumes of such low value: retail banks sending overseas worker remittances and making over-the-counter foreign exchange payments; corporates that maintain operations in several jurisdictions; and banks acting as paying agents on behalf of government bodies or pension funds. All of these bodies will encounter additional difficulties, such as having to retain multiple accounts to send payments to different locations in different currencies. And the common practice of treating the foreign exchange element of a transaction separately to the actual payment will increase the number of bank interactions for the instructing body, potentially incurring additional fees.

For certain institutions, there may even be a reputational risk involved in processing these types of transactions. Take, for example, a paying agent for a large corporates pension scheme. With increasing numbers of people opting to retire abroad after a life's work, it is likely that the agent will be making a significant number of overseas payments. The typical situation will likely involve the payments being made in the domestic currency of the pensions plan – normally by electronic transfer though sometimes by cheque – with the beneficiary taking the responsibility for securing the funds in their local currency.

However, this latter part of the process can often suffer from a lack of transparency that can be frustrating – not to mention costly – for the beneficiary of the payment. The foreign exchange rates applied may change unpredictably and bank charges levied locally may appear somewhat arbitrary. Indeed, as a result, it is likely that a situation will arise where two beneficiaries – theoretically entitled to identical benefits – will be receiving differing amounts depending on the practices of their local bank. And the local availability of funds can also be an issue: even electronic transfers can sometimes result in unpredictable availability, depending on how the transaction is processed. A



How does FX4Cash work?



similar situation will exist for institutions making regular cross-currency payments for the purpose of worker remittances. In both cases, the end result may be beneficiaries unhappy at what appears to them to be a lack of transparency and certain arbitrariness in the process, and dissatisfaction at the level of service they feel they have received.

A new approach

Of course, the range of potential difficulties currently associated with this type of business means the leading transaction banks have been looking at this for some time, and Deutsche Bank is no exception. Developed over several years and bringing together expertise from the Global Markets (GM) and Global Transaction Banking (GTB) divisions, Deutsche Bank has recently launched a new platform designed to give clients a range of end-to-end payment solutions for their cross-currency needs.

That the new platform, FX4Cash, brings together the areas of the bank responsible for foreign exchange and payments processing is significant as Deutsche Bank has sought to address the practice of handling these two parts of a transaction separately. Instead of treating the foreign exchange as a post-payment factor – with the relevant information being supplied to the client after the payment is made in order for them to make the necessary reconciliation – FX4Cash allows them to see the rates being applied at the start of the business day, or during the day at the exact time they are being applied. This should allow corporates to better manage their cross-currency transactions in order to ameliorate their liquidity position. Indeed, FX4Cash leverages Deutsche Bank's online foreign exchange trading platform, autobahnFX, in order to seek the best rates from one of 18 funding currencies into 75 local currencies, whether on a spot, same day, next day or forward trade basis. And on the payments side, the platform utilises Deutsche Bank's new payments architecture designed to replace ageing systems and cope with both high volumes, as well as recent and future changes in regulatory standards.

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From the point of view of fellow financial institutions, partnering with Deutsche Bank's FX4Cash platform allows them to mitigate some of the difficulties and risks associated with processing these types of payments. Indeed, through capitalising on the foreign exchange spreads, such partnering can even lead to the realisation of new revenue streams.