A hidden opportunity

FOREIGN EXCHANGE CROSS-CURRENCY PAYMENTS NEED NOT BE THE NUISANCE THEY TRADITIONALLY WERE. **TIMOTHY MERRELL** OF DEUTSCHE BANK EXPLAINS HOW.

Executive summary

Lower value cross-currency payments have traditionally been a costly nuisance for many corporates and financial institutions. But Deutsche Bank's new single platform for both foreign exchange and payments processing cuts a two stage process down to one and aims to make the whole system more straightforward and efficient.

Payments with a foreign exchange element are estimated to have a wallet of over $12bn[1] annually, with cross-border transactions representing approximately 8% of all payments[2]. Many of these payments are likely to be of a relatively low value and, traditionally, those corporates and financial institutions making large volumes of relatively low value cross-currency payments have encountered a number of difficulties. Sometimes termed "nuisance payments", cross-currency transactions are often costly in terms of both time and expense for the institution instigating the transaction.

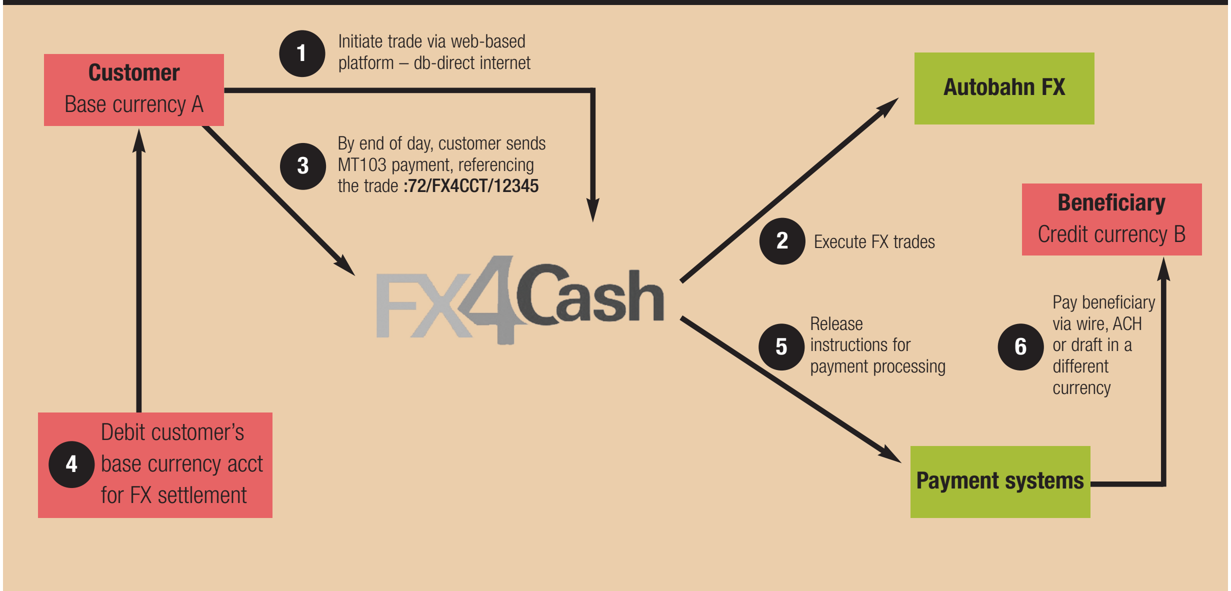
SOMETIMES TERMED 'NUISANCE PAYMENTS', CROSS-CURRENCY TRANSACTIONS ARE OFTEN COSTLY IN TERMS OF BOTH TIME AND EXPENSE FOR THE INSTITUTION INSTIGATING THE TRANSACTION

ENCOUNTERING PROBLEMS Despite the issues, there are many examples of such payments: retail banks making over-the-counter foreign exchange payments and sending worker remittances; banks acting as a paying agent for government agencies or pensions administrators; and corporates that maintain operations in several countries. All these entities will make regular, relatively small value, cross currency payments. Problems will include having to hold multiple accounts in order to pay beneficiaries in several locations and currencies, while the foreign exchange element of the transaction often lacks transparency. In addition, the practice of handling the payment and foreign exchange elements of a transaction separately increases the number of bank interactions for the instructing institution.

REPUTATIONAL RISK In some cases this may even pose a reputational risk for the institution originating the payment. For example, a paying agent for a large corporate pension scheme is likely to be making overseas payments to retirees that have emigrated or returned to their country of origin. This would typically involve the payment being made in the originating currency – say pounds sterling – with the beneficiary responsible for securing the funds in their local currency. There can be a lack of transparency here that could result in beneficiaries entitled to the same payment receiving differing amounts thanks to the application of seemingly arbitrary local bank charges. A similar situation exists for institutions making cross-currency payments for worker remittances and, in both cases, this perception of a lack of transparency and arbitrariness may lead to unhappy beneficiaries.

JOINT VENTURE SOLUTION The leading global banks have been looking at this issue, and Deutsche Bank is no exception. Developed as a joint venture between the Global Markets (GM) and Global Transaction Banking (GTB)

Figure 1: How does FX4Cash work?



divisions, Deutsche Bank has recently launched FX4Cash, a platform designed to offer end-to-end cross-currency payment solutions (see *Figure 1 above*).

It is significant that this initiative involves a partnership between the areas of the bank responsible for FX and payments processing, as Deutsche Bank has sought to address the problem of cross-currency transactions being handled in two distinct steps, with the foreign exchange element previously being considered a post-payment factor. This generally entails the foreign exchange information being provided to the client after the payment is executed. However, with growing demand – especially from corporate clients – for more efficient tools for managing their transactions and liquidity position, many need to know the foreign exchange rates before their business day starts or during the day at the point when the rates are being applied. Obviously, the leading banks are keen to fill this gap. The thinking behind the design for FX4Cash is to give clients equal access to the foreign exchange capability alongside the payments capability. The platform leverages the capability of Deutsche Bank's foreign exchange trading platform to seek the best rates in over 75 local currencies – whether traded as spot, same day, next day or forward trade.

PAYMENTS ARCHITECTURE Technology is another major issue. With much of today's payment infrastructure relying on technology that is several decades old, many institutions are encountering significant operational risk due to the danger of failing systems. And the investment required to build new infrastructure may be too great given the tough economic climate. Of course, the leading banks are all trying to respond to this issue. Deutsche Bank's approach has been to develop a new payments architecture that connects clients regardless of access channel to existing leading edge foreign exchange and payments platforms. Aside from the problem of ageing infrastructure, today's competitive payments environment has led to many financial institutions and payments providers facing the challenge of shrinking revenues due to price compression and regulatory initiatives such as the Single Euro Payments Area (SEPA). This has led to some providers seeking to offset their diminishing fee revenue with other sources of income. Partnering with one of the leading payments banks is one way of allowing them to realise new revenue streams from the foreign exchange spreads on cross-currency payments, while offering an enhanced service to their clients.

WITH MUCH OF TODAY'S PAYMENT INFRASTRUCTURE RELYING ON TECHNOLOGY THAT IS SEVERAL DECADES OLD, MANY INSTITUTIONS ARE ENCOUNTERING SIGNIFICANT OPERATIONAL RISK DUE TO THE DANGER OF FAILING SYSTEMS.

[1] *BCG Global Payments*
[2] *www.epaynews.com*

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