
Borderless FX
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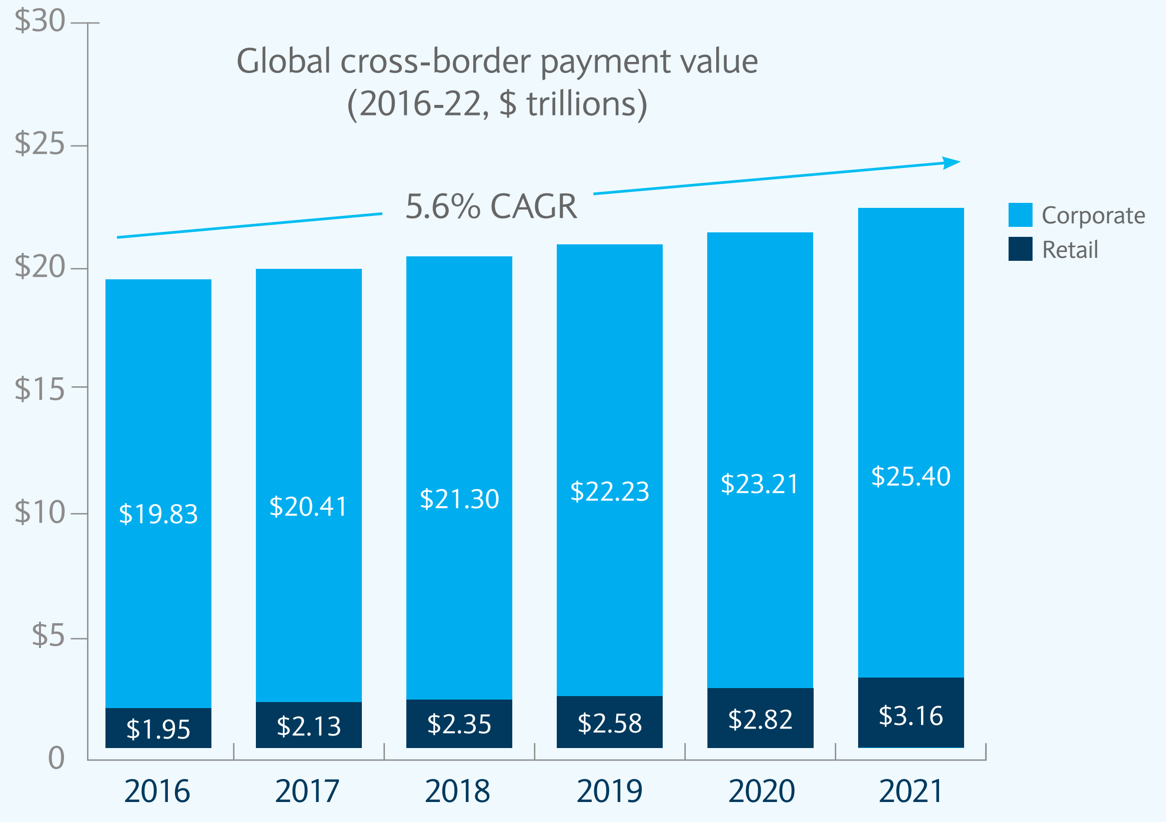
Growth in international payment volumes

International payment volumes are continuing to grow on the back of trade expansion. In fact, international payment volumes are growing at an even faster rate than global GDP growth. While the International Monetary Fund (IMF) has forecast global GDP growth of 3.7% for 2018[1], the overall value of cross-border payments for the year is estimated at $23.6 trillion and is set to keep increasing at a rate of 5.6% per annum[2].

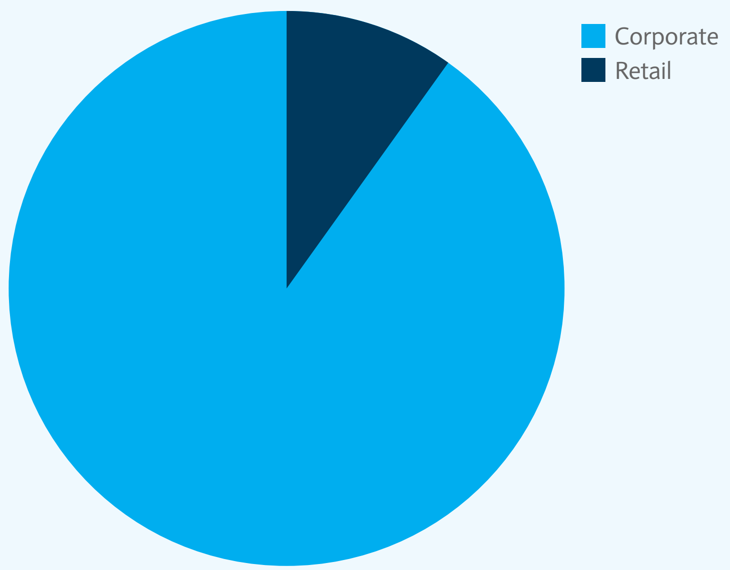
Business-to-business payments comprise around 90% of total international payment volumes. Consumer payments make up the other 10%, growing at a rate of almost 25%. Much of this expansion can be attributed to the market disruption created by fintechs and the emergence of new online payment service providers. Going forward, the consumer payments space is set to become even more exciting as financial services companies, technology companies and fintechs invest in new products and solutions that will benefit consumers.

International payment volumes are growing at 5.6% p.a. due to increased global trade

Cross-border payments continue to grow...



...though it is dominated by the B2B flows



- Overall cross-border payment value in 2018 is $23.6 Tn and growing at 5.6% p.a.
- 90% of cross-border payment flows are corporate (B2B)
- 10% of cross-border payment flows are retail (C2C, C2b, B2C) but growing at ~25% per year

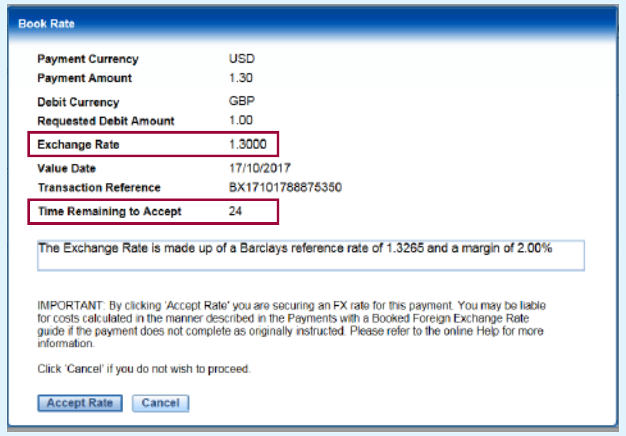
Source: Accenture report based on World Trade Report

90% of cross-border transactions are low value i.e. <$100k in value

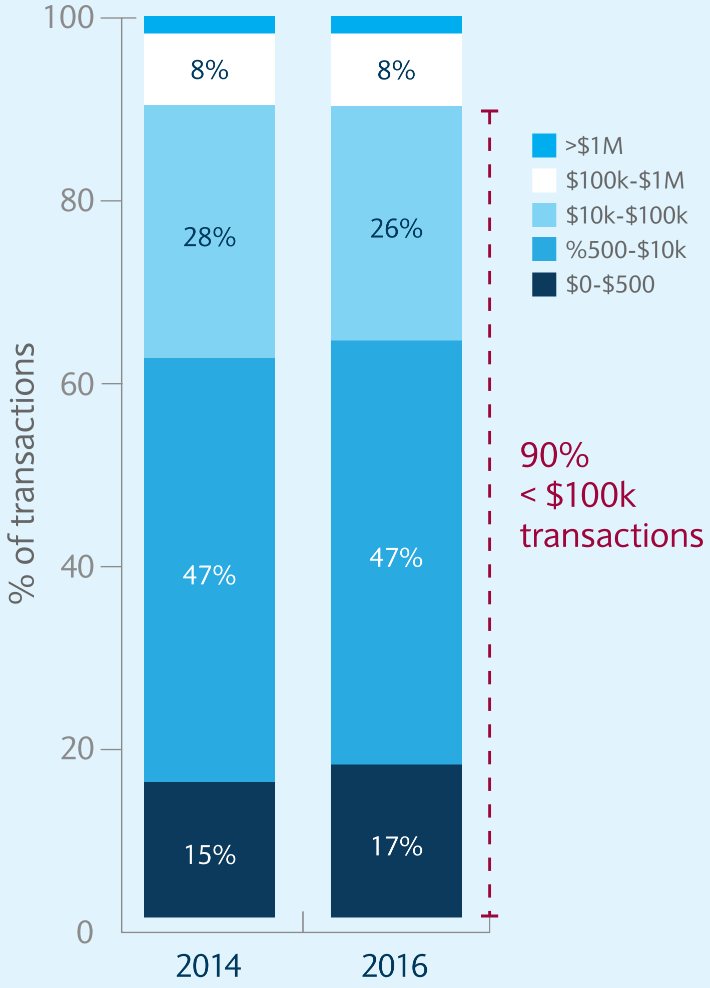
Advancements in banking technology have reduced friction in cross-currency payments…

FX dealer channel innovations:

1. Embedding cross-currency payment capability in banking channels
2. Live FX price streaming
3. Bulk booking of FX rate
4. Offering simple hedging solutions (FX Forwards & Swaps)



…resulting in increased growth of low value cross-border transactions



Source: SWIFT Watch, based on MT 103s sent between 2014-2016

Cross-border transactions

Significantly, the vast majority (90%) of cross-border transactions are less than $100,000 in value. This reflects enhancements in banking and financial technology over the past two decades, which have made it much easier to move money from one country to another, and from one currency to another. Businesses of all sizes can now move money efficiently all over the world.

Four particular FX innovations stand out for their contribution to reducing friction in cross-currency payments:

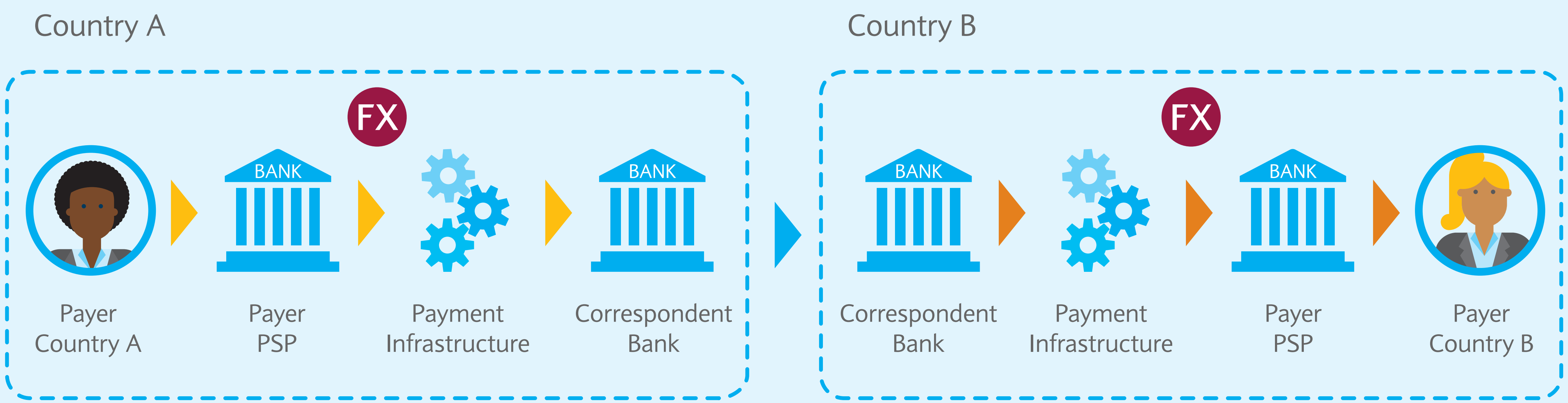
- Live FX price streaming that provides transparency around pricing and margins;
- Bulk booking of FX at pre-agreed rates;
- Banking platforms that offer cross-currency payment capability; and
- Simple hedging solutions (FX forwards and swaps), which are being integrated with payment and banking platforms.

Increasingly businesses are able to integrate their core FX activities with their payment channels, allowing them to move money and manage their FX risk more efficiently. Nevertheless, while corporate treasuries have good visibility and pricing awareness of high-value FX transactions (typically because they handle these transactions themselves), they have less visibility and pricing awareness of transactions below $100,000 in value. That is because the organisation's payment factories and shared service centres will usually absorb these lower-value transactions as part of their accounts payable and accounts receivable processes. The invisibility of low-value FX transactions to corporate treasuries presents a pricing concern for organisations since they often occur in large volumes and are dealt with by numerous financial institutions all over the world. As a result, organisations have an opportunity to make cost savings by optimising and streamlining some of their low-value FX payments.

Reducing friction in cross-border payments

The international payments system relies on a lot of the traditional payment and FX infrastructure. There are multiple friction points within this system, however, due to the existence of multiple

Distributed Ledger Technology (DLT) could reduce frictions in cross-border payments



Friction points

Multiple friction points in the traditional international payments infrastructure due to:

- Use of multiple banks
- Payment infrastructures of different countries are disconnected
- FX trading, clearing and settlement involves multiple processes

Distributed Ledger Technology (DLT):

DLT has the potential to reduce friction in the cross-currency payment space:

- Correspondent banking settlements could benefit from lower friction through DLT1
- Multiple pilot projects are looking to reduce the back-end FX settlement processes using DLT e.g. CLSNet[1]

Source: 1. BIS report, Cross-border retail payments, February 2018

payment infrastructures and multiple FX trading, clearing and settlement processes. Furthermore, multiple correspondent banks will often be involved with moving money from one country to another.

Distributed Ledger Technology (DLT) could potentially reduce friction in the cross-currency payment space by significantly improving correspondent banking settlement systems as well as FX trade and settlement processes. For this reason, a number of pilot projects are underway to investigate how DLT could be used to reduce back-end FX settlement processes. One example is CLSNet, a bilateral payment netting solution developed by CLS and IBM. CLSNet, which is built on a DLT platform, can be used to optimise intraday liquidity, enable real-time awareness of currency and counterparty exposures, and reduce risk. While these pilot projects are currently in their infancy, they are set to have significant implications for the way international payments are made in the years ahead.

Cross-border ecommerce ecosystem

Today more and more businesses have significant ecommerce channels. In fact, ecommerce is one of the fastest growing channels, particularly for businesses in the retail and travel sectors.

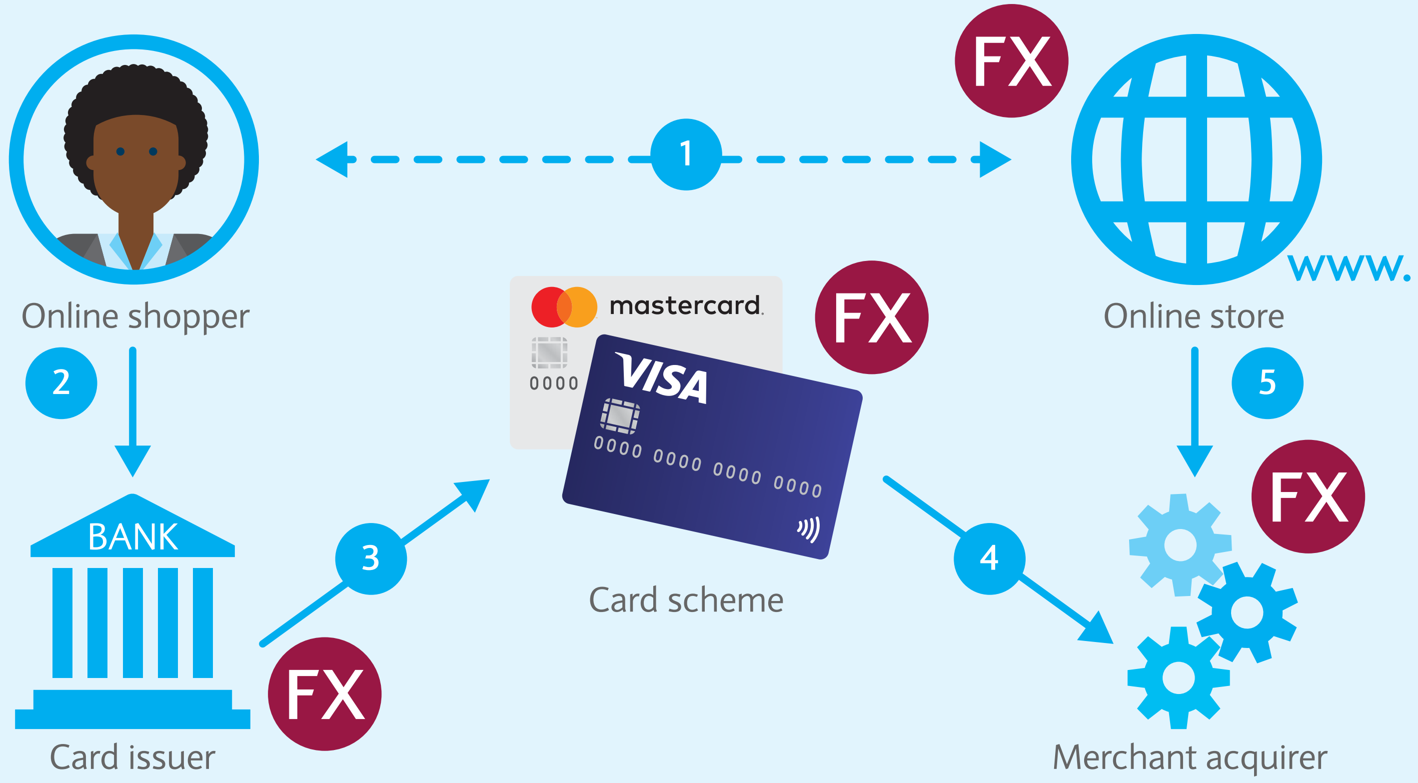
Unfortunately, multiple FX-related friction points exist within the cross-border ecommerce ecosystem. These frictions are caused by the traditional card payment network, in particular the number of participants involved with facilitating cross-border ecommerce payments.

The participants typically include a card scheme, a card issuer that issues the payment card to the consumer, and the merchant acquirer that helps to settle the transaction with the merchant. Each of these participants, as well as the online store that the consumer purchased from, often applies an FX spread. Overall, the cross-border online shopper could be getting charged an FX spread of 3%-5% or more due to these FX frictions.

As businesses compete for market share, they will want to reduce the FX spread that their online shoppers must pay. So a lot of FX innovation is likely to take place in the cross-border ecommerce ecosystem in future.

Multiple FX related friction points remain in the cross-border eCommerce ecosystem

Cross-border Online Shopping: FX Frictions



Transaction steps:

1. Online shopper buying cross-border online
2. Card issuer of online shopper debits their card account
3. Card issuer settles with card scheme
4. Card scheme settles with the merchant acquirer
5. Merchant acquirer settles with the online store

FX Frictions: Description

1. **STEP 1:** Online stores often use dynamic currency conversion which could load margins on the FX rate
2. **STEP 2:** Card issuers in many markets charge an FX conversion fee which tends to be between 2%-3%
3. **STEP 3/4:** Card schemes while providing competitive FX rates may also apply a margin
4. **STEP 5:** Merchant acquirers if doing the FX to settle in online stores base currency could charge a separate FX margin

Overall, the cross-border online shopper could therefore be paying a significant FX margin due to the above.

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To find out more about how your organisation can save money by optimising and streamlining FX payments, speak to your Barclays Relationship Director.

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1. https://www.imf.org/en/Publications/WEO/Issues/2018/09/24/world-economic-outlook-october-2018

2. https://www.accenture.com/_acnmedia/PDF-85/Accenture-International-Payments-Digital-World-International-Payments-Digital-World.pdf