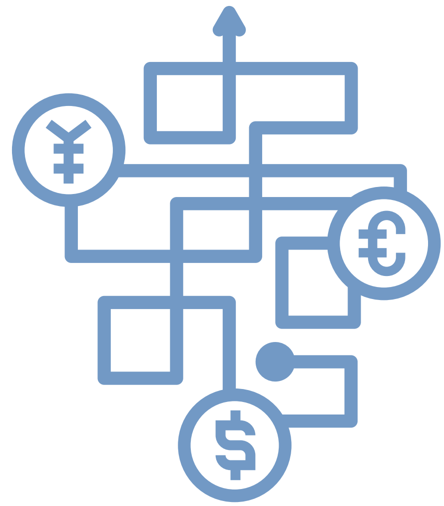
Goldman Sachs | TRANSACTION BANKING

More Than Just the Spread: The True Cost of Global FX Payments

May 2021

Working Through the Complexities of Global Money Movement



For decades, international payments have served as the facilitator for cross-border trade and commerce, paving the way for the emergence of new industries and market providers.

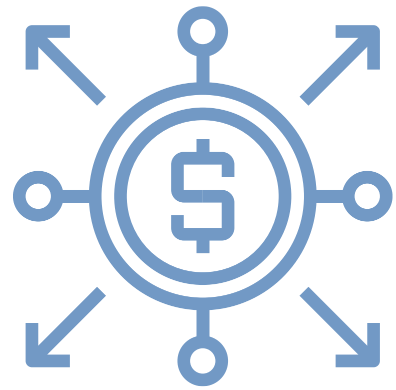
And, until COVID-19, it seemed that nothing could slow down the growth in global trade or payments. As 2021 progresses, many expect global commerce to resume its steady growth—perhaps even at a heated pace this year—as the world economy rebounds from the wide-reaching pandemic. That would boost trade volumes in terms of overall notional values and the number of foreign exchange (FX) transactions themselves.

Payments to vendors, manufacturers, suppliers, and service providers have never been more critical on the corporate front. They impact other business processes as well: expatriate payroll, intercompany flows, tax payments, health care subsidies. Those are just some in a long list of cross-currency requirements—transactions that all need to happen securely, swiftly, and seamlessly.

Of course, many corporations know that payments, especially cross-border transactions in different currencies, are anything but simple. They can involve numerous time zones, jurisdictions, and regulations. Global payments can be hard to track and slow to settle. Traditional transactional FX solutions have been constrained by a lack of flexibility, confusing payment formats, and a dearth of customization to suit the needs of users. That last point opens the door for new providers to enter the process, a move that could create efficiencies but is as likely to add more to bottom-line costs. Further, the back-end systems that help power many industry incumbents have proved unpredictable—as legacy mainframe computers are known to need regular functionality and maintenance updates and often face issues in dealing with high-volume processing at scale.

Of all these issues, one of the more basic ones—the lack of transparency in terms of the cost to execute FX payments—is perhaps the most nettlesome. Many multinational corporations still face issues when trying to determine their complete end-to-end cost base when it comes to transacting in foreign currency payments. We believe this is an issue that can be addressed and solved. ■

Navigating the Costs of FX Payments



A few basic factors comprise the cost of an FX transaction—among them are exchange rates, spreads, costs of funds, and correspondent bank processing fees, or the fees tacked onto the fee charged by the bank originating the transaction.

While existing market providers might stress that one factor is low (lower than that of a competitor), that same institution might have high fees for another factor, offsetting those savings; in other words, clients should be cognizant and considerate of their overall costs to ensure the most optimal output of the pricing they receive across these different transaction components.

There are also other factors to consider. Some financial institutions charge a commission for handling and executing the trade—either a fixed fee (set irrespective of value) or a relative fee (the higher the value, the higher the commission). It also is common for banks to charge clients for each payment they make or even ones they do not (some banks have inactivity fees for those who fail to meet a monthly or quarterly minimum). On top of that, market providers may add fees for posting each payment to a client's account. In many cases, banks charge a regular fee for providing a monthly statement of those transactions or for generating data analytics on the payments processed.

What is behind all of these charges? Mostly technology, as the upkeep of legacy banking infrastructure, global onshore operations, and a general liquidity footprint can create a large cost base that requires multifaceted revenue streams to offset. For banks, global payments are a very meaningful slice of their business. And clarity on what they are charging customers for global payments can be as elusive as in the notoriously convoluted 25-page cellular phone bills of old. And, like with those phone bills, miscellaneous fees tend to add up.

Further, sunk legacy costs are to blame for some excessive fees with other providers who do not have a manageable cost of funds. When Goldman launched its transaction banking business in 2020, it found there was a strong advantage in being relatively late to the game. "We weren't saddled with legacy infrastructure and processes," said Hari Moorthy, Partner, Global Head of Goldman Sachs' Transaction Banking (TxB). "We challenged ourselves to find out if there was a better way and, if so, to build a better system." ■

A Simplified and Transparent Approach to FX Payments

From its inception, TxB prioritized robust cross-currency payment solutions that could scale with client needs and enable them to know what they will pay for at each step in the process.

For instance, a client might want their inbound FX receipts seamlessly converted to a group of predetermined target currencies. TxB allows clients to input their preferred settlement parameters, including method of payment and currency types. That might seem like a given, something that any transaction banking platform would provide. But it is not, and many banks are set up to facilitate payments in the currency and method of their choosing for their own benefit.

This is how TxB strives to put the client in control. A French company might want to pay an American supplier in euros, but that supplier might prefer to be paid in U.S. dollars. A manufacturer in Japan might seek to pay all of its vendors in yen, while its main vendors might want to receive payment in kroner. Payables, receivables—there is no one-size-fits-all solution in the global economy.

TxB's response was to adopt a technology-and-digital-first mindset regarding transaction banking—introducing a platform developed from scratch in the cloud, built entirely on APIs, which offers the possibility for a more intuitive, flexible, and data-rich approach. These features could make clients' lives easier by digitizing and improving the payments experience. And, critically, they could give them control over what processes are most important to them. Most important, TxB strives to remove any miscellaneous and ancillary price points that clients face and to be completely transparent and simple in terms of what clients are paying for. ■

Putting Clients Back in Control of Their Cross-Currency Payments

In terms of pricing, TxB has worked to eliminate traditional market charging and billing practices–opting for a simple pay-for-what-you-use model.

There are no miscellaneous fees, such as a monthly fee to turn on FX services. TxB even took a proactive approach to protecting its clients by preventing funds from being pulled out of an account without authorization, introducing as standard a debit block feature, free of charge.

"When you build from scratch in the cloud with agile digital architecture you don't need to concoct a range of fees to offset the cost of legacy infrastructure," said Eduardo Vergara, Global Head of Product & Sales at TxB. "We don't have that cost so we can price our offerings for the value of the services we are providing to them."

Finally, when it comes to FX pricing, TxB prenegotiates spreads with no hidden or additional charges. That means clients know what they are paying for. And, because Goldman Sachs has a global liquidity network (and transacts in more than 127 currencies), the FX rates that are used for execution in many corridors are market competitive and support an overall path to reducing the cost of an FX transaction. TxB will even work with clients to perform historic rate analyses that will compare past FX activity with market benchmarks and calculate potential savings for clients on a go-forward basis across both rates and spreads offered by Goldman Sachs.

As noted above, there are several factors that determine the price of executing an FX payment transaction—the spread, the rate, and additional transaction fees. But then there is the issue of getting that converted money to a beneficiary. This process includes sending funds over the correspondent banking channel, and, of course, each

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time a different party touches the process, there is a chance for additional fee application. These "lifting" fees and beneficiary bank account fees add up for all parties involved in a global payment. TxB provides its clients with access to a host of alternative, direct-to-account payment rails and has a global network of bank partners that may help alleviate the cumbersome fees of the past.

Allowing clients to operate in multiple currencies, especially for collections and receipts, is another example of how the TxB approach to solving simple problems is front and center in its solution strategy. For instance, consider a credit card processing client who does not need every inbound payment converted into a single currency but rather would prefer to hold multiple currency accounts. TxB is launching just such a methodology. Soon clients will be able to operate currency accounts in, say, all G20 currencies. That will reduce the cost and effort of completing FX payments for the sake of FX fees. It also will enable a company to keep an account in yen, for example, so it can complete transactions in yen, without having to buy and sell the currency, repeatedly. One might say, that is great but with multiple accounts comes a proportionate amount of time and fees related to maintaining dozens of physical accounts. That is not the case. Goldman Sachs has reduced these ancillary charges so that an increased account footprint does not directly correlate with a higher monthly billing statement. Problem solved.

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It Is a Journey…

It is abundantly clear that the global payments market will continue to evolve. A confluence of factors is driving that change, including the impact of technology, client expectations, global demographics, and regulations. There are also a significant number of changes in global trade flows and industry fluctuation, as developments in a post-COVID-19 economy continue to emerge.

The market is already being reshaped by both traditional and emerging payment providers—not only legacy banks but also fintech firms and corporates that are pivoting to offer payment solutions. As a result, service providers as well as users are beginning to seek off-the-shelf solutions that can be tailored to achieve the best results for all parties.

Payments are at the core of transaction banking, and the drive toward more transparency—from the operational execution to the cost of making the payment itself—has emerged as crucial. Global payments are even more integral to international business operations in need of supporting their customers and dealing effectively with their suppliers. Only with additional information can a company make informed decisions about how to optimize its operations. For years, this was an opaque corner of operating a treasury or cash management function; clients struggled with setting up the most-efficient FX execution processes and continued to face legacy commercial pricing strategies at incumbent banks where miscellaneous and ancillary fees had become the norm or were viewed as the cost of doing FX business.

Moving cash from one location to another should be a simple process. That is what Goldman Sachs built when developing its Transaction Bank. By helping clients navigate the current complexities of the global payment ecosystem, TxB is striving to put its clients back in control when it comes to managing their cross-currency payments. ■

For more information, please see the Transaction Banking (TxB) LinkedIn page at
www.linkedin.com/showcase/goldman-sachs-transaction-banking/