

14. Banks: International Trade and Finance Services

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14.1 Introduction

Banks play a vital role in facilitating international trade. When physical goods are being shipped across national borders significant risks arise due to the time lags involved in transportation and from imperfect knowledge about the characteristics of the counterparty involved in the transaction. Payment prior to receipt of the goods exposes the purchaser to the risk of non (or delayed)-delivery and/or inferior quality. If payment is to be made after receipt of the goods, the seller faces the risk that the purchaser may not make payment. Seeking legal action associated with either of those situations involves costs and difficulties associated with dealing with the legal system of a foreign country. In addition, differences in

currency preferences of buyer and seller mean that banking services will be needed to facilitate the foreign exchange transaction. If the international trade is in services (rather than physical goods) the same issues arise due to the need to enter contracts for provision of services and verify that the agreed services have been suitably delivered.

Banks provide *trade finance* facilities to enable importers and exporters to undertake international transactions at much reduced risk. These may be part of a larger relationship between a bank and its customer such as provision of finance for the production of goods which will be ultimately repaid by the sale overseas. History tells us that banks followed their customers overseas to facilitate trade and to maintain relationships and business with firms that established overseas operations. Also, firms dealing in international markets face foreign exchange risk. The AUD value of a USD payment due or expected can vary significantly if the AUD/USD exchange rate changes. Banks will offer FX hedging services (forward FX, swaps and options), and advice relating to their use, to their customers which can be used to mitigate such risks. These risks will also exist for the many Australian companies which have established operations overseas and where the AUD value of that investment may depend on changes in the exchange rate.

Global capital markets also create a role for banks to facilitate overseas borrowings or investments by their clients. For large entities, imperfections in financial markets may make it cheaper in AUD terms to issue debt, or borrow, offshore in a foreign currency and swap the proceeds and future repayment obligations into AUD terms. Banks will both facilitate the process of raising funds in the foreign market and provide the hedging (swap) facilities. Likewise, investors (such as Australian superannuation funds) will want to purchase foreign financial assets (such as equities) but may not want to have the AUD value of those assets fully exposed to changes in the value of the AUD against foreign currencies. As well as facilitating the transaction, banks can provide the required hedging facility for the investor, generally, but by no means always, undertaking an offsetting position with other market participants to reduce the risk taken on by the bank and lock in a profit from the spread on the two transactions.

The growth of international financial markets and global financial centres has also encouraged large banks to establish a presence in foreign markets in order to participate in such markets.

14.2 Trade Finance Facilities

All of the major banks provide detailed information on trade finance facilities on their websites¹, and hence only a brief overview is provided here.

Delivery versus Payment

As mentioned earlier, the lags involved in international shipment create risks arising from differences between delivery date and payment date. Banks can help ameliorate these risks by providing facilities that ensure payment is made when delivery is verified or vice versa. And part of their ability to do so arises from the fact that banks in each country will have better knowledge of the counterparty in their country involved in the transaction. While an exporter in Australia and importer in the UK may have little information about honesty, reliability, and credit-worthiness of each other, they each will have a relationship with a bank in their country, and the two banks in the two countries will have a relationship with each other. Thus the informational deficiency separating the exporter and importer can be overcome by the chain of better informational links between the Australian exporter and her Australian bank, that between the Australian and UK banks, and that between the UK bank and the UK importer.

There are, at least, five general methods for dealing with the non-synchronous nature of delivery and payment.

1. Payment made by the importer prior to delivery – this is high risk for the importer, but low risk to the exporter.
2. *A Documentary Letter of Credit* – where the importer's bank promises to pay the exporter the amount due either once shipment has occurred or at some later agreed date, as long as the terms in the letter are met. These will include receipt of a *bill of lading* which reduces the risk of non-shipment to the importer. The exporter is guaranteed payment if the terms of the letter are met and there is no credit risk of non-payment by the importer's bank. For a fee the exporter could get her local bank to *confirm* (guarantee payment) by the foreign bank.
3. *A Documentary Sight Collection* – when the shipped goods arrive the goods will not be available for collection from the shipper until change of ownership documents are provided. In this method, the importer's bank pays the exporter's bank to receive and hold those documents and only releases them when the importer has made payment. The importer still has the risk that the goods are not exactly as ordered.

¹ See, for example, [NAB](#), [ANZ](#), [CBA](#), [Westpac](#).

4. *Documentary Term Collection* - here the bank provides the documents to the importer, enabling them to inspect the goods, on a promise of repayment once that is done.
5. *Payment post shipment delivery* - the importer pays once the goods have been delivered – which is high risk to the exporter.

These methods of payment involve difference allocation of risks between the two parties. By having trusted banks involved – as in methods 2 to 4, the risks can be ameliorated. Of course the banks are also involved in methods 1 and 5 due to the need for a currency conversion.

14.3 Services for corporate and institutional clients

Managing Foreign Exchange (FX) exposures

Business clients of the bank who operate in overseas markets are exposed to risk due to exchange rate fluctuations. First, the domestic currency value of already known future foreign currency cash flows can be altered. Such an exposure is referred to as a *Transactions Exposure*. Closely related are *Translation Exposures* which refer to the impact of exchange rate changes on accounting statements such as the corporate balance sheet if, for example the business has assets or liabilities denominated in a foreign currency. The second major type of effect (and the most important) concerns the impact of exchange rate changes on the ability of the firm to compete in domestic and/or foreign markets. An exporting firm's ability to profitably generate future foreign currency cash flows can be affected by exchange rate changes. An import competing firm may find, for example, that a strengthening of the AUD enables overseas producers to achieve greater penetration of domestic markets. These are examples of **Operating exposure** (sometimes also referred to as **Economic exposure**) reflecting the dependence of company's value upon the exchange rate through its impact upon competitiveness of its operations.

Advising business clients on the nature of the FX exposures and providing solutions to adjust such exposures to a preferred position is an important activity of banks. Transactions exposures will generally be easy to identify, and various forms of FX hedging can be provided – such as forward FX or options contracts sold to the customer. Similarly for translation exposures – although accounting conventions can create some issues for the impact on financial statements. It may be, and this also applies to economic exposures, that an appropriate form of FX hedging might involve borrowing (or investing) in foreign currencies, and the bank will be able to provide, or arrange, such facilities.

As well as operating businesses, banks will also provide FX hedging facilities to financial institutions (and high net worth individuals) wishing to change the risk associated with investing in foreign assets (such as equities and bonds). Superannuation funds have become important clients in this regard. [NAB](#) provides information on FX hedging practices of Australian super funds from a biennial survey. Hedging magnitude and approaches used differs between funds and over time, but as a generalisation, super funds hedge between 30-40 per cent of international equity exposure and around 50 per cent of foreign fixed interest exposure. In the 2019 report NAB indicated that many super funds were focusing less on a “hedge ratio” and more on achieving some desired level of exposure to foreign currencies.

Foreign Bond Issuance by Australian Companies

Larger Australian companies have tended to issue bonds into international markets rather than into the Australian domestic market. One popular market has been the US Private Placement market. Typically these bonds will be USD denominated and a cross-currency-interest-rate swap will be used to convert the borrowing into a synthetic AUD borrowing. To issue in such markets, the company will need the services of placement agents and Australian major banks will typically act as a co-agent supporting the US banks who act as the placement agents. Similarly when issuing debt into other international markets, companies will typically need the services of a major investment bank from that jurisdiction, with Australian banks being associated with the issuance process.

Kangaroo Bond Market Issuance

The Australian major banks are important players in arranging access to the Australian financial markets for international issuers of AUD denominated bonds – the so-called Kangaroo Bond market. This is a substantial market involving supranational, sovereign or quasi-government agencies (SSAs) and international companies and financial institutions (see Bergmann and Nitschke ([RBA 2016](#)) for more information). Table 1 provides information on the lead arrangers of Kangaroo Bond issues since 1996. The four major banks are in the top 9 lead arrangers with around a 30 per cent share of the market. While the rankings vary year by year, these figures provide a reasonable indication of their role in recent years.

TABLE 1: KANGAROO BOND LEAGUE TABLE (1996 - 2021): SOURCE: [KANGANEWS](#)

Bookrunner	Volume AUD Mill	No. of Deals	% of Total Volume
TD Securities	74,880	674	16.8
RBC Capital Markets	63,896	520	14.3
ANZ	40,298	300	9
Commonwealth Bank of Australia	40,162	257	9

Deutsche Bank	38,596	371	8.7
Nomura	29,438	313	6.6
Westpac Institutional Bank	28,800	182	6.5
UBS	27,049	155	6.1
National Australia Bank	25,107	154	5.7

14.4 Correspondent Banking

Banks play a crucial role in facilitating international payments. Generally, the two end-parties in a transaction will have different currency preferences. A US seller of goods to an Australian, for example, will want ultimate payment as a USD credit to their bank account in the US, while the Australian purchaser will want to make payment using AUD funds in their Australian bank account. A very costly and inefficient way of doing this could be for the Australian to buy US currency from her Australian bank and post those to the US purchaser to deposit in his US bank account.

Not surprisingly, banks around the world have, long ago, established inter-bank arrangements and systems which enables low cost, efficient, and risk free transfers of funds across national borders.

A correspondent banking relationship arises when one bank provides banking services to a bank from another jurisdiction. And typically the relationship will be reciprocal. “At the most basic level, correspondent banking requires the opening of accounts by respondent banks in the correspondent banks’ books and the exchange of messages to settle transactions by crediting and debiting those accounts.” ([CPMI, 2016](#))

Banks use the Latin terms *Nostro* (*ours*) and *Vostro* (*yours*) when referring to accounts held by one bank at another bank. A *Nostro* account is one held at a foreign bank usually in that foreign currency. A *Vostro* account is one held on behalf of a foreign bank. Thus, if XYZ bank from the US had an AUD account in Australia with CBA bank, XYZ would record that as a *nostr*o account whereas CBA would record that as a *vostro* account. The same account is referred to by different terms depending on whether the perspective is from the account holder or the account provider.

CBA provides a list of its correspondent banks on its [website](#), and has, for example, Bank of New York Mellon and Barclays Bank as its US and UK correspondent banks respectively. If CBA has funds in its *nostr*o account with Barclays (for example) that balance would be included among cash and liquid assets in CBA’s

accounts. If CBA offered an AUD account to Barclays, the amount in that Vostro account (from CBA’s perspective) would be a liability in CBA accounts.

One feature of recent decades has been a decline in the number of correspondent banking relationships which has prompted attention from international agencies concerned about possibly damaging effects on trade and financial flows and financial inclusion in emerging nations. Behind the decline in numbers is the risks associated with correspondent banking. Unless the counterparties involved in the chain of transactions are well known and reputable, there is a major risk of falling foul of AML/CTF legislation and incurring significant fines.

A Correspondent Banking transaction example

While CBA has a correspondent banking relationship with Barclays, the UK recipient of a payment from a CBA customer might have an account with a different UK bank (Bank of Scotland, for example). Barclays would then be involved in transactions with both CBA and Bank of Scotland to ensure the payment ultimately reaches the bank account of the intended recipient.

Figure 1 provides a highly simplified illustration of a correspondent banking transaction enabling the Australian, Jo, to make a payment of USD 100 to Pi who banks with ABC Bank in the USA. The example assumes that the exchange rate used in all transactions is USD 1 = AUD 1.50, and does not provide detail on how the messages between banks are sent. (Note that as an alternative to crediting Yank Bank’s account with it, Aussie Bank could have instructed Yank Bank to debit Aussie’s account with it by USD 100).

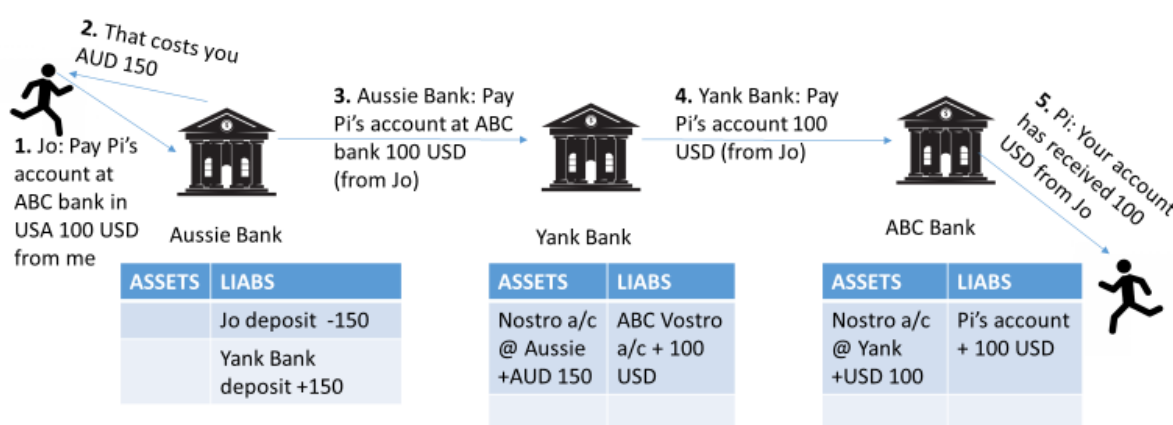


FIGURE 1: A SIMPLIFIED CORRESPONDENT BANKING TRANSACTION

14.5 International Payments Arrangements

Payments across international borders nowadays involve banks sending digital (electronic) messages through the SWIFT network to banks in other countries to make transactions on the sending bank's account at the receiving bank. Before the advent of "wire transfer" mechanisms, the process involved mailing of bank cheques or orders to the foreign bank to pay a third party by drawing upon funds held in an account held at the foreign bank.

The SWIFT Network

SWIFT (the Society for Worldwide Interbank Financial Telecommunication) was established in 1973 (and operational from 1977) as an international payments messaging platform. As well as the platform enabling users to interface with and access this service and the computer systems to transfer the messages, it also developed protocols or standards to be used in messages. With the development of the internet new interfaces (other than direct leased telecommunication lines) have been developed, and technological improvements have reduced the messaging price charged to around 3 Eurocents per Kilocharacter (a thousand characters).

It currently provides such facilities for over 11,000 entities such as banks (including central banks), securities organisations, market infrastructures and large corporates. A number of the banks are also its owners under its cooperative ownership structure which relates shareholdings to usage of the service. Not all banks will be directly connected to SWIFT, with smaller entities relying on dealing via larger banks and their correspondent banking relationships.

As well as payments services, SWIFT also provides technology underpinning many securities organisations and market infrastructures where both the settlement payment and the transfer of ownership of assets needs to be effected and recorded.

A SWIFT message

The standards developed by Swift enable payment messages to be sent between banks in different countries. A message will involve a number of required, as well as optional, fields. These specify, *inter alia*: details about the sending and receiving bank; information about accounts to be debited or credited at the receiving bank and subsequent transaction information to enable payment to or from the ultimate end user; the amount(s) involved.

Figure 2 provides an example in which the Australian payer's bank is a member of SWIFT, but the British receiver's bank is not. The originating bank in Australia sends instructions to its correspondent bank in the

UK to debit its GBP account with UK bank and credit the account of the recipient's UK bank which, in turn is to credit the recipients

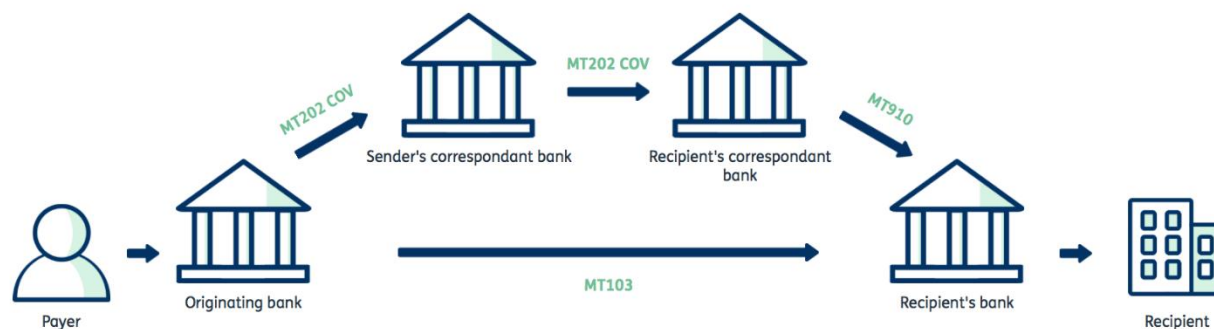


FIGURE 2: SWIFT MESSAGE: SOURCE: [MONEY MOVER](#)

14.6 Remittances and Retail FX transactions

Remittances are transfers of money between individuals, generally across borders and involving an exchange from one currency to another. They may reflect an underlying business transaction, but are more generally thought of as involving transfers of funds between family members in different countries – such as gifts or repatriation of earnings in a foreign country. These transfers have traditionally been done through a range of informal networks, small businesses, large money transfer operators (such as Western Union), and banks. However, in recent decades, the growth of internet business allowing international purchases via the web has increased the amount of small business-related foreign currency transactions and seen the growth of new participants such as PayPal and internet-based foreign exchange transfer service companies such as [CurrencyFair](#) and [Wise](#). These platform based services (which can, for example, match retail customer demand and supply where possible and trade any overall imbalance at wholesale rates, leading to them providing prices close to wholesale rates) can be expected to eventually reduce the wide margins which bank retail customers face in making foreign exchange transactions. This [2019 ACCC report](#) on retail foreign currency conversion services provides valuable information).

The remittance industry has a long history, often traced back to around 700AD in China ([Buencamino and Gorbunov, 2002](#)). Physical transfer of currency by trusted agents was one mechanism used, as was use

of banks based on their correspondent banking networks in foreign countries. The term “remittance man” referred to expatriates from countries such as the UK, living in Australia supported by funds sent from their families in their home country – often under the condition that they never return home.

It is a large industry, with the [World Bank](#) reporting transfers reaching \$554 billion in 2019. Official statistics include a range of transactions including: transfers (eg of wages) from individuals currently overseas to family members in their home country; wages of guest/temporary workers; migrants transferring wealth to their new country. Remittances from workers overseas are important for increasing living standards in low income countries. For many such countries, remittances are larger than foreign direct investment, and the [World Bank](#) outlined problems arising from the decline (after many years of strong growth) in remittances in 2020 and 2021 associated with reduced global mobility and economic downturn arising from the Covid crisis.

Figure 3 (from [Andreassen, 2006](#)) provides a schematic example of the remittance process which highlights the issues involved for users of remittance services. They include: risk of a transaction being successfully completed; speed; convenience; complexity and cost. With modern technology, the instruction to pay, and availability of funds can be virtually instantaneous, as can be the settlement of the foreign exchange transaction between the local and the foreign agent – particularly if they are part of the same bank or other financial firm. But that was not always so, and when the recipient has limited access to financial institutions, such as not having an account at a bank acting as the foreign agent the process can be problematic. Many of the transactions are for relatively small amounts (\$200 or so) such that costs charged can be a large proportion of the total.

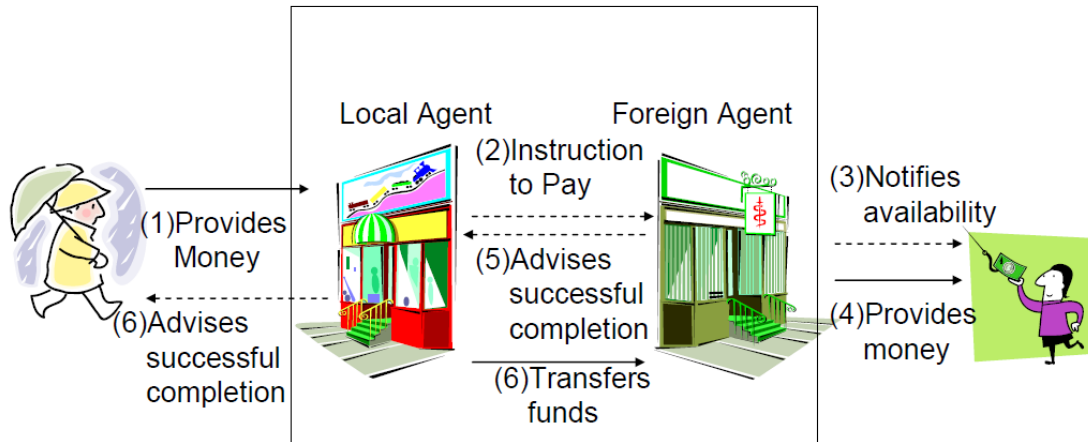


FIGURE 3: THE MONEY TRANSFER PROCESS: AN ILLUSTRATION

For many years, authorities have been concerned about the cost of such transactions – particularly since many users are lower income groups (such as guest workers in a foreign country making remittances of relatively small amounts to their families in their home country). Those costs can reflect explicit fees charged and the exchange rates used in the conversion from one currency to another. International agencies and governments have been attempting to lower the cost of remittances, which the [World Bank](#) estimated was an average of 6.51 per cent of the amount sent in 2020 (down from 9.67 per cent in 2009). The costs vary depending on the countries involved and the remittance provider, with banks generally being the most expensive. Digital remittances sent to bank or other non-bank transaction accounts or e-money accounts are among the cheapest.

Also of concern to authorities is the role of remittances as a possible way of money laundering and financing of terrorism. In response to concerns about AML/CTF, many banks have closed accounts of small, informal, money transfer operators – reducing the range of options available to individuals wishing to remit money. In Australia, Westpac was one bank which adopted such an approach, but then became mired in scandal, and in 2020 was [fined \\$1.3 billion by AUSTRAC](#), due to extensive money laundering activities of some customers not being recognized and reported.