White paper: Implementing transparency & fairness in cross-border payments for Australian consumers

Problem: High costs of international payments

Consumers are unclear on the true cost of moving money due to hidden mark-ups in exchange rates raising cost of living by hundreds of dollars a year

Because of market failure to provide adequate information, consumers and small businesses pay too much to make international payments.[1] Payment service providers including banks claim low fees, with the majority of the consumer charge in a marked up exchange rate. For example, a bank will say transferring $10,000 US Dollars to the US costs $0, but they fail to disclose that there's a 3.6% mark-up over the mid-market rate, making the cost more like $572 AUD than "free".

If a consumer saw a total cost of $572AUD to send $10,000 US Dollars, they might have been inclined to look for alternatives. But right now, opaque attributes in price make comparison near impossible, which limits competition and keeps costs artificially high. There is no transparency, comparability and therefore no price competition.

Even if a sophisticated consumer calculates FX mark-up on the first transfer, some industry participants practice quietly increasing mark-ups on future transfers.

In order to implement transparency, this paper sets out practical policy solutions that help tackle this problem and highlight why other measures may be deficient.

In 2017, Capital Economics estimated that this lack of competition **costs every Australian household *at least* $500AUD a year**.

This cost to consumers will only increase given the trends towards further globalisation, further international payments and increased use of global supply chains by small and medium enterprises.

The potential benefits to the Australian economy through increased productivity and efficiency in the economy come on top of the benefits to consumers and households of reductions in costs for everyday items. In 2017 we estimated the potential benefit to the Australian economy of the elimination of hidden fees in international payments as being **$3.1bn in direct benefit** every year to Australian consumers and businesses.

[1] Understanding Foreign Exchange, Consumer Study, YouGov, Prepared for Wise, August 2021, available upon request

Solution: Setting a benchmark rate to stop hidden fees in consumer and SME payments

Consumers can only compare providers if all providers use the same baseline

Under the head of power contained in s39(1)(a) of the *Banking Act 1959* regulation should require providers of online international money transfers to show a benchmark, mid-market FX rate to customers simultaneously with the retail FX rate offered by the provider under which the transaction will be performed.

Against this informational benchmark FX rate, providers should then be required to illustrate the cost of any transaction made under their retail rate in dollar or percentage terms.

Simultaneously through ASIC rules and other delegated legislation, a principles based regulatory regime establishing what is an appropriate **aggregated mid-market rate** should be developed.

This should allow financial institutions to deliver an aggregated mid-market rate from one of a variety of sources. However, there should be minimum standards set to ensure that the benchmark rate used is sufficiently populated with raw data as to be a reliable indicator of mid-market rate and be informative for the consumer.

Wise notes that this mid-market benchmark rate should be explicitly for an informational purpose and not wholesale trading purpose. That is to say, trades cannot be made from the mid-market rate unless the payment service provider so wishes.

If standards for benchmark rates are set across the industry, customers could be shown the real total costs of transactions compared across providers would motivate more comparison shopping and more competition.

Finally, regulation would also be required to ban firms from implying that an international transfer has no cost only to have the true cost hidden in the FX rate.

Who should be covered by this regulation?

In order to ensure that this regulation does not unduly impact smaller firms and those who are unable to shoulder the regulatory burden, this regulation should be explicitly crafted to not impact providers of international payments and currency exchange services under a particular volume to be determined by the government.

For the avoidance of doubt, the purpose of this regulation should be made explicit as to ensure that consumer and SME electronic payments are made more transparent and competitive and should *not* be a mechanism to regulate the wholesale trading of currency in the FX market.

Finally, this regulation should be rolled out to those currencies which have sufficient two-way volume so as to ensure the presence of a sufficiently liquid market for the presence of a meaningful mid-market rate.

What is the right benchmark?

There are three options.

1. A commercially available aggregated mid-market rate: recommended

The mid-market rate is the middle price point between bid versus offer spreads of a given currency route on FX markets: an aggregated mid-market rate takes an average across a variety of providers for a particular market.

Aggregated mid-market rates are provided as a fee for service products from firms such as Morningstar, Bloomberg, Reuters (Refinitiv), Intercontinental Exchange or New Change FX. These products must be adequately delayed so as not to impair the commerciality of these products from private firms.

Refinitiv's rate service is already used by central banks around the world, including the Reserve Bank of Australia, Monetary Authority of Singapore and the Bank of Canada.

While there are many mid-market rate providers in the industry, policymakers should set criteria for what makes an appropriate benchmark rate. For example, rate providers should be independent of payment service providers, collect data on a certain minimum amount of currency volume, have credible governance structures in place and rely on accountability frameworks included in their rate collection.

Government has constructed similar frameworks for other significant financial benchmarks. While we do not recommend that aggregated mid-market rates be included in the Corporations Act, Part 7.5B Framework for the regulation of financial benchmarks, we do recommend that some regulation be put in place which would ensure that the use of aggregated FX rates are consistent and robust.

Wise acknowledges that there is an implementation cost for the provision of a mid-market rate to customers but that the cost of this implementation is small when compared to the potential consumer and competition benefit of illustrating prices of these services to consumers across the economy.

2. A central bank rate: not recommended

In many countries a central bank reference rate, usually published on its website, is not a practical benchmark for three reasons:

- **Most central bank rates are published once a day** meaning firms providing real-time rates would move to daily rather than real-time pricing. The G20 roadmap for enhancing cross-border payments sets out that the overwhelming majority of cross-border payments on a global level should be delivered within an hour by 2027.[2] Using a daily central bank rate will undermine that ambition.

Firms could continue to price based on real-time mid-market rates to reflect intraday currency movements while at the same time comparing it to the central bank rate, but there is risk of confusing customers by having a (potentially negative) mark-up over the central bank rate.

- **Only a limited number of currency routes are monitored by central banks.** The US Federal Reserve only lists 23 currencies, while the European Central Bank features 30 currencies and the Reserve Bank of Australia only 17. This means that for currencies not listed, firms either need to look at other central banks, or source these rates externally through third party providers.

  In the US, regulation that determines pricing policy for remittances already excludes a list of exotic currencies[3] as they often lack a sell market.

- **Central bank rates differ depending on the country**. Wise has found that at times central bank rates differ on currency pairs. This raises confusion as to which central bank a firm should refer to for a given currency pair and firms will opt for the rate which works in their favour. Additionally, if a central bank rate becomes the benchmark, firms need to monitor central banks all over the world to ensure that they have coverage for the currencies they offer, adding an operational burden.

Some central banks still collect their reference rate through teleconference with some of their largest banks and fix the rate at a certain time while other central banks have updated their rate collection. For example, the Bank of Canada uses Refinitiv on a minute-by-minute basis to build a weighted average FX rate for daily publication.[4]

Were the Canadian Central Bank to simply publish their minute-by-minute feed it would largely solve the time lag issue and ensure firms display a rate that is more reflective of intraday movement.

3. A combination of both: not recommended

A third, more complicated option is available which combines both a stale central bank rate and an aggregate mid-market rate. If updating a central bank reference rate more frequently is not an option, policymakers could mandate firms to stick to the central bank rate "fix" at a specific point in time (e.g. for the Bank of England's reference exchange rate, this is 4pm).

[2] https://www.fsb.org/2023/10/g20-roadmap-for-enhancing-cross-border-payments-consolidated-progress-report-for-2023/
[3] Federal Register, safe harbor list of countries that qualify for an exception in subpart B of Regulation E
[4] https://www.bankofcanada.ca/rates/exchange/background-information-on-foreign-exchange-rates/#calculation_methodology

It would be important that firms showcase intraday currency movement. This could be achieved by enabling firms to display an aggregate mid-market rate from an approved list of third party, independent providers.

The same outcome can be achieved by requiring that the mid-market rate sources need to be calibrated to central banks at certain points in time or, alternatively, demonstrate to the regulator why the central banks haven't achieved a representative fix in the market. Administratively, this puts an additional burden on rate providers.

Wise does not recommend this solution as requiring mid-market rate providers to align with the central bank fix at a certain point in time, it may result in providers gaming this requirement by creating a dead zone in the market - avoiding trading at the central bank fix time.

Disclosing the cost in monetary terms vs percentages

Wise acknowledges that there are ongoing studies by the Behavioural Economics Team at the Department of Prime Minister and Cabinet who are looking into this issue. While we do not wish to pre-empt their findings we note that other studies have demonstrated that consumers respond more to a presentation in dollar terms rather than percentage terms.[5]

This may differ in respect of business transactions or high value transactions, where costs are often expressed in percentage terms and there will be more familiarity with this format for accounting purposes.

What does this recommended solution look like?

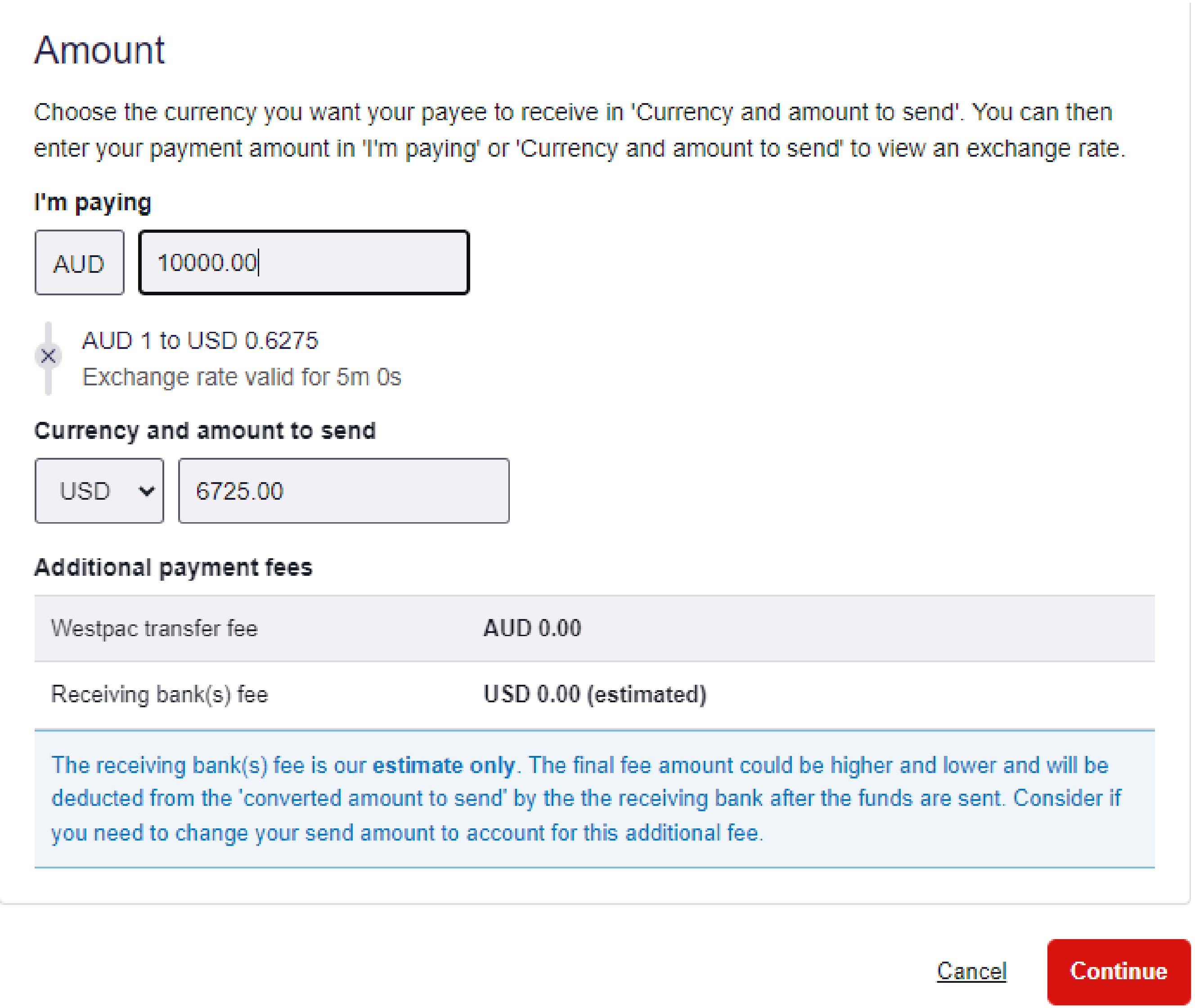
Banks and payment firms already have a common approach to pricing. It's generally a combination of an upfront, fixed fee and a variable, often hidden, percentage fee on top of the benchmark exchange rate that the provider uses. That price should be reflected in the cost providers show customers. It is crucial that customers see the total cost of a transaction expressed in monetary values for retail transactions.

The consumer must see:

- The same (or materially similar) benchmark exchange rate across every bank and payment firm;
- The total cost in absolute terms, including the variable fee (i.e. the retail mark-up over the benchmark exchange rate);
- Amount in local currency they're sending;
- Amount the recipient receives in foreign currency.

[5] Why consumers respond differently to absolute versus percentage descriptions of quantities

(Figure 1: The current formulation for the presentation of prices to customers)



(Figure 2: Wise's proposed formulation for the presentation of transparent costs in international transfers)

Amount

Choose the currency you want your payee to receive in 'Converted amount to send'. You can then enter your payment amount in I'm paying' or 'Converted amount to send' to view your exchange rate.

I'm paying

AUD | 10000.00

AUD 1 to USD 0.6275
Westpac exchange rate valid for 5m 0s

AUD 1 to USD 0.6526
Mid-market rate as of 8:31PM EST 11/19/23
This rate is sourced from Bloomberg LLC and is for information purposes only

Converted amount to send

USD | 6275.00

Transfer costs

Westpac transfer fee	AUD 0.00
Receiving bank(s) fee	USD 0.00 (estimated)
Exchange rate markup	AUD 251.00
Total cost	**AUD 251.00**

The receiving bank(s) fee is our **estimate only**. The final fee amount could be higher and lower and will be deducted from the 'converted amount to send' by the receiving bank after the funds are sent. Consider if you need to change your send amount to account for this additional fee.

Cancel | **Continue**

Price Volatility

While firms may be required to "lock in" the fixed part of their price, the variable percentage fee they charge should be allowed to fluctuate to reflect FX risk during periods of extreme volatility.

Volatility is sudden and time limited in its nature, so locking in a variable price is counterproductive because it will encourage providers to adopt higher margins than they otherwise would, which will drive up costs for consumers. Even in high volatility situations firms should disclose their mark-up over the mid-market rate.

In all, this is not a particularly difficult issue to solve and is not a barrier to the implementation of price transparency.

Conclusion

If all providers prominently display **a benchmark exchange rate** and the total cost is calculated in a similar manner across providers, then consumers and businesses can accurately compare banks, payment firms and switch to the one that is cheapest or best suits their needs.

It is crucial that ***the total cost*** is the most prominent displayed element for consumers to see when they examine a provider's offering such that a reasonable customer would not miss it.

This is an important policy improvement for consumers, which affects an estimated $200bn of hidden charges globally. However, regulators will find that banks and established payment firms will try to make technical and operational objections to keep the practice to obscure their fees.

Therefore, it is especially important to offer a pragmatic policy solution and an implementation schedule. For example, the requirements can be implemented faster online than in physical locations, or the first phase could cover the 30 largest currencies, for which mid-market rates are well established. The policy should eventually protect every retail consumer - whichever currency they use or wherever they purchase the payment service. This solution is straightforward to implement, despite the concerns that will inevitably be raised.

Appendix 1: Suggested Formulation of Regulations for Price Transparency in International Currency Transfers and Payments

Price Transparency in Foreign Currency Payments

1. This Regulation applies to Payment Service Providers of Foreign Currency Transactions, as defined under s761A of the Corporations Act:
    a. Who offer money transfer that is initiated online directly, using the website or the mobile banking application of the Payment Service Provider, and;
    b. Whose volumes of international payments exceed $XXXXXAUD in a given rolling 12 month period, and;
    c. Who offer foreign currency transfer, exchange or payments services from AUD to any one of the following currencies:
        i. US Dollar
        ii. Pound Sterling
        iii. Euro
        iv. Japanese Yen
        v. Canadian Dollar
        vi. Singaporean Dollar
        vii. New Zealand Dollar
        viii. South Korean Won
        ix. Malaysian Ringiit
        x. Indonesian Rupiah
        xi. Indian Rupee
        xii. Brazilian Real
        xiii. South African Rand
        xiv. Israeli Shekel
        xv. UAE Dirham
        xvi. Mexican Peso
        xvii. Further currencies XXXXX
2. Payment Service Providers and parties providing currency conversion services, shall provide on their website in both public locations and throughout the process of a customer making an international payment:
    a. A digital price tools showing:
        i. The total amount that will be sent by the sender
        ii. The total amount to be delivered to the recipient
        iii. The total amount of any fixed fees incurred by the sender or the recipient.
        iv. A benchmark mid-market rate of an acceptable standard placed prominently adjacent to the retail rate offered by the Payment Service Provider.
    b. An expression of the total currency conversion charges inclusive of a percentage mark-up/dollar amount over a mid-market rate, fixed fees or other fees which might be estimated by the Payment Service Provider.

    c. That the total charges shall be disclosed to the payer prior to the initiation of the payment transaction.
3. These digital price tools should be easy to use and be customisable to a customer's intended IMT value and destination.
4. Payment Service Providers shall also make the mark-up referred to in paragraph 2(b) public in a comprehensible and easily accessible manner on a broadly available and easily accessible electronic platform.
5. An appropriate benchmark rate as referred to in paragraph 2(a)(iv) should be a benchmark, mid-market exchange rate for the relevant currency pair offered by a firm which:
    a. Operates in Australia or is able to be referenced in Australia; and,
    b. Sources data directly on foreign currency trades through financial institutions Australian currency pairs; and,
    c. Aggregates this data on trading currency pairs into a mid-market rate being the difference between the bid and ask at any given point in time; and,
    d. Sells or provides for free this mid-market rate which can be accessed by Payment Service Provides through an API or similar; and,
    e. Is subject to any rules on the provision of Financial Benchmarks that ASIC may see fit to set under s908CD of the Corporations Act.
6. Any benchmark rate used under paragraph 4 may be delayed in respect of time by up to 10 minutes.
7. Nothing in this regulation shall impede the functioning of Part 7.5B of the Corporations Act 2001.