White paper on Auto Foreign Currency Conversion
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Note: Relevant regulations and any applicable legislation take precedence over the guidance notes issued by this body. These guidelines represent an industry's best effort to assist peers in the interpretation and implementation of the relevant topic(s). The PMPG - or any of its members - cannot be held responsible for any error in these guidelines or any consequence thereof.

1 Introduction

The Payments Market Practice Group (PMPG) is an independent body of payments subject matter experts from Asia Pacific, Europe and North America. The mission of the PMPG is to:

- take stock of payments market practices across regions,
- discuss, explain, and document market practice issues, including possible commercial impact,
- recommend market practices, covering end-to-end transactions,
- propose best practice, business responsibilities and rules, message flows, consistent implementation of ISO messaging standards and exception definitions,
- ensure publication of recommended best practices,
- recommend payments market practices in response to changing compliance requirements

The PMPG provides a truly global forum to drive better market practices which, together with correct use of standards, will help in achieving full STP and improved customer service.

2 Purpose

Foreign currency auto conversion services are increasing. As such the purpose of this paper is to explain foreign currency auto conversion and to outline some of the unintended consequences that may occur as a result of those services. The PMPG is proposing a series of best practices to avoid unintended conversions and to achieve better STP rates. It is also the opinion of the PMPG that banks offering auto conversion services need to safeguard the end to end contracts between sending and receiving parties.

3 Background

It is not unusual for the senders of wire transfers to order payments in their local currency when the receiver may not be able to receive or be paid in that currency. In the absence of multi-currency accounts, receiving banks upon receiving foreign currency transfers usually convert it to their local currency to facilitate payment to their customer. An increasingly predominant practice to facilitate efficient processing is for the sending bank to automatically convert the transfer to the local currency of the receiving country or partner up with an intermediary bank providing auto conversion services. The level of services provided is driven both by technical capabilities of the service provider and the destination market practices. The foreign exchange conversion is largely governed by the legal agreements an account holder has with their bank which may contemplate the use of correspondents and the automatic conversion of funds.

While this is a practical solution that can increase straight through processing for the receiving bank, it has unintended consequences to the underlying customers. The impact/benefit to business and personal customers varies slightly. Both are discussed below.

4 Definitions

Auto Conversion refers to the automatic or systematic conversion of a payment from the currency specified by the ordering party to some other currency (usually the currency of the destination country) by any bank in the payment chain.

Sending Bank refers to the bank ordering the payment on behalf of their customer.

Receiving Bank refers to any bank receiving the transfer in the payment chain including the beneficiary bank and intermediary banks.

Converting Bank refers to the any bank that converts the transfer from one currency to another.

5 Business to Business (B2B) Payment

There are two issues faced by businesses when banks apply foreign currency auto-conversion practices. First is the existence of contracts and/or invoiced currencies and the second is the existence of multi-currency accounts.

Contracts/Invoice Currency

Buyers and sellers often have relationships where contracts and invoices prescribe the acceptable means and dates of payments for products or services rendered. They usually specify the currency of the payment which may be different than the buyers own currency. The seller of the service usually wants to be paid in their own currency to minimize their exposure to any foreign currency fluctuations or in a specific currency for other contractual reasons that banks would not have awareness of. They will manage their accounts receivables flows by amount, references and foreign currency liquidity (including what has been invoiced in a currency as well as the invoices to paid-out in that same currency).

When a wire is unexpectedly converted, it causes exception or manual processing in the accounts receivables processes. It can lead to claims to banks to receive the exact amount expected in each currency.

Multi-Currency Accounts

The second issue is the existence of multi-currency accounts within a single bank. Sellers of goods and services may maintain multi-currency accounts at their banks in other jurisdictions (ie outside the one paying them). This complicates the auto-conversion practice because the sender may be quoting an account number to be paid that is in fact the currency of the invoice. As well, when customers do not have accounts in a specific foreign currency they often expect their bank to defer to them on how to handle the currency received.

As a result of the above issues, it is possible that a payment in a local currency destined to a multi-currency account in a foreign jurisdiction may be auto converted unknown to the sender and then converted back unknown to the receiver. Depending on the foreign currency fluctuations, the bank(s) in this transaction may have claims against them regarding how they processed the transaction. Imagine the beneficiary customer who was expecting an amount agreed to in an invoice receiving something less. The cost of investigating this is not inconsequential and will involve many different stakeholders beginning with the buyer and seller having to investigate why an amount different than what was ordered was delivered.

6 Person to Person (P2P) Payments

Person to person payments are likely ordered in the local currency due more to lack of knowledge on the part of the sender than in the case of B2B. They are less likely to be connected to a contract, although there are many practical situations in which they may be such as the purchase or sale of property in another jurisdiction.

The sender of personal wires and the bank employees who service them are generally less sophisticated in their use and knowledge of wire transfers (notwithstanding, there are some personal users of wires who would understand them well). Often the personal use of wire transfers is conducted on a less frequent basis and usually to the same beneficiaries.

Generally, we would expect auto conversion to have less impact to personal customer. Chances are the beneficiary bank would have converted the transfer to local currency anyway. However, it is still possible that a personal user of the wire service is sending to someone who has a multi-currency account. Hence as in the B2B scenario, double conversion could occur.

It is prudent even with P2P to apply auto conversions to low value payments only. The rate of false conversions is likely to be higher for high value payments. High value payments are usually from high value, sensitive customers. High-value personal payments would tend to be linked to contracts as mentioned above.

7 Payments Market Practice Group Assessment

The converting bank assumes the risk of auto-converting wire transfers. If multiple banks in a chain convert a transfer multiple times without express instructions from the ordering party to do so, it is the first bank in the chain that who auto-converted that is responsible for losses. Had they not made the first erroneous auto conversion, the subsequent receiving banks would have been acting in good faith according to their client agreements, bank policies and local market practices. An exception to this would be for service arrangements covered through bilateral agreements between banks.

Banks offering auto conversion services need to deploy appropriate customer management and risk management strategies. Part of such management strategies should include:

- Transparency with ordering customers on the conversion process (i.e. inclusion in legal agreements; product descriptions). Ordering customers would need to receive information on the benefits and impacts of using or not using Auto Foreign Currency Conversion.

Consider Regulations, where applicable, that encourage transparency and competition (e.g. Dodd Frank 1073, Payment Services Directive) and provide information guidelines.

- Provide an "opt-out" facility and/or an exception list by categories like debit account/s, ordering customer/s and/or beneficiary customer/s, threshold amounts.

- Analysis of target customers to identify those customers who could potentially be negatively impacted.

- Analysis of the value of transfers in scope, understanding foreign currency risk increases with value.

-Analysis of the type of transfers in scope, understanding in particular B2B payments. In commercial payments Buyers and Sellers often have contracts and invoices that specify the currency of the payment and the beneficiary may wish to decide upon FX conversion when receiving funds.

- Market analysis to ensure understanding of the global markets where multi-currency accounts are typical across all client segments. These markets are likely to cause issues with auto-conversions

- Deployment of an efficient customer service strategy including expedited return/compensation processes and expedited re-payment in the right currency when the payment has been returned to the sending bank in case of false conversion.

- Use of fields 36 (Exchange Rate) and 33B (Currency/Original Ordered Amount) and/or equivalent fields in ISO 20022 to support the beneficiary's reconciliation

By implementing appropriate market practices for auto conversion services, banks can minimize negative business/consumer experiences. This manages reputational risk to the banking community that could otherwise lead to increased regulatory scrutiny.

This and other PMPG information is available on their website: www.pmpg.info
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