FinBox

The Fintech solution to cross-border financing

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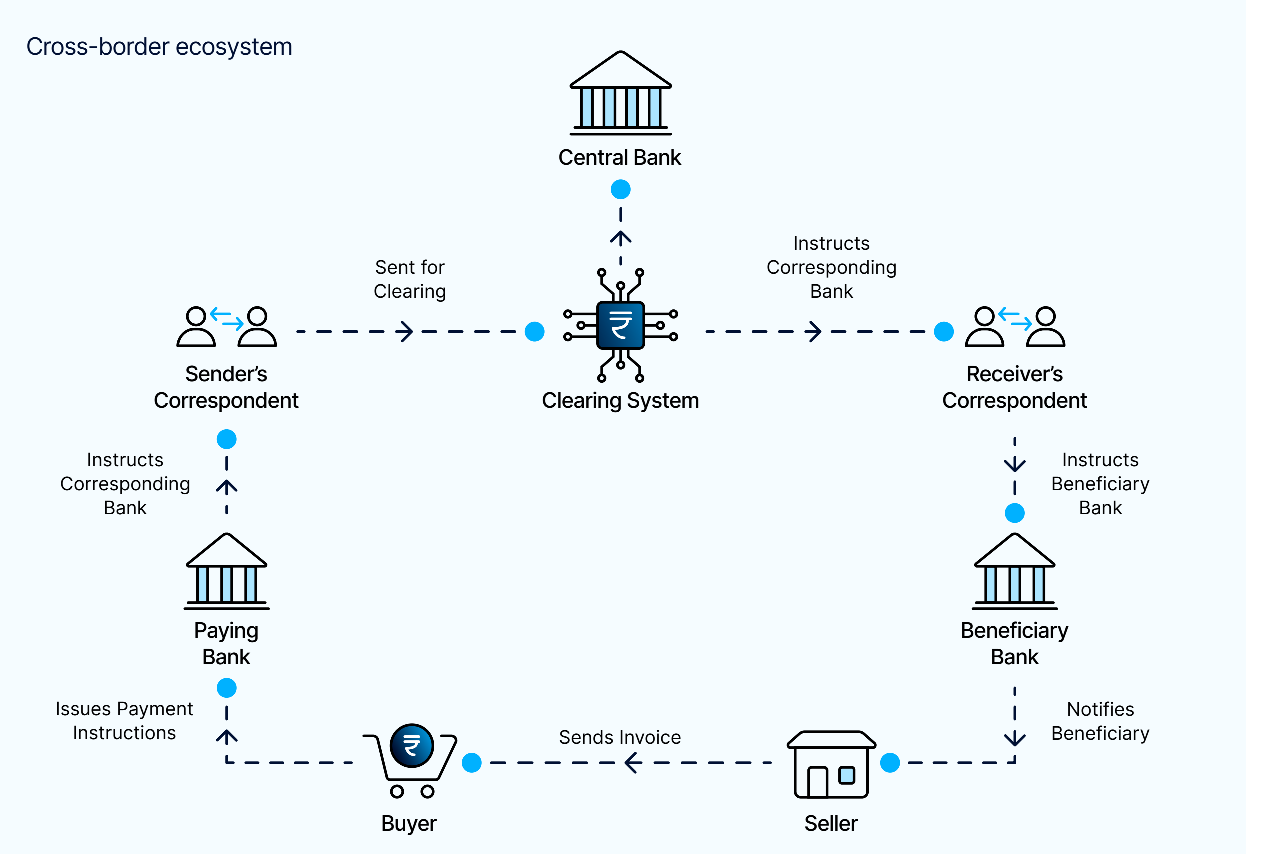
How lenders can navigate regulations to enable cross-border financing

When globalisation was at its peak, those who managed to squeeze out the redundancies in the world's product supply chains gained the most. Only when the pandemic struck, and lockdowns in Asia threatened the world's supply chain, was it clear how fragile the system can be. The world's financial supply chain is crucial and fragile too, only far more complicated.

Cross-border financing involves issuers covered by regulators in one country and buyers covered by regulators in another. The risks involved are plenty but nobody really has a grasp on it. There is a lot of information on the value of global portfolio investments and how it has soared, but you can't tell precisely where it is invested or by whom.



Source: The Digital Fifth

For businesses looking to expand globally, it's important to understand regulations and payment cultures. A 2017 survey revealed that while credit cards are ubiquitous in the US, cash on delivery is popular in Hungary. In Poland, a kind of direct bank transfer, pay-by-links, is used. In emerging markets, alternative payments comprise much of the payment ecosystem and companies benefit from establishing a local entity to accept these types of payments - an expensive and time-consuming undertaking.

The neglected step-child of the payment ecosystem

Much like supply chain efficiencies, the benefits of cross-border financing spill over into jobs and development. Everybody wins. But the cross-border banking system has not kept up with the average consumer who wants convenience at a low cost. The dissonance comes in the form of regulatory complexity, regulatory diverergence, and few other challenges

Risk

Foreign investors, especially staid financial institutions, may not understand how much risk they're taking on. Some investors might not properly guage the risk of default. Some might overestimate the liquidity of their investment or the extent of exposure to currency fluctuations.

Cost

Cross-border financing is notoriously expensive. The number of intermediaries involved in one transaction and their service fees, along with regulatory costs, and FX (foreign exchange) fees will multiply the cost to business.

Time

A typical cross-border transaction takes four to eight days - agonisingly long compared to a domestic UPI transaction. This is obviously because of the numerous entities involved. For instance, if someone from Ukraine wanted to transfer money to Sri Lanka, it may have to go through parties in Germany or Russia and then India before it reaches the final destination. They are as undeniably complex as they sound, however, businesses and customers want what is fast, convenient, and inexpensive.

Cybersecurity

Whenever money enters a new country, it runs the risk of being exposed to hackers. Countries with soft security and access policies are leaving businesses and consumers vulnerable to cybersecurity threats, which aren't just about lost money but also lost reputation.

Transparency

A 2017 SWIFT and EuroFinance survey revealed 64% businesses want real-time tracking, while 47% wanted visibility on costs and deductions involved.

The opportunity cost

Lenders that fail to manage cross-border compliance efficiently face not only fines, penalties, and high operating costs, but also risk missing out on significant business opportunities.

€5.8bn

Fines paid by financial institutions

15-20%

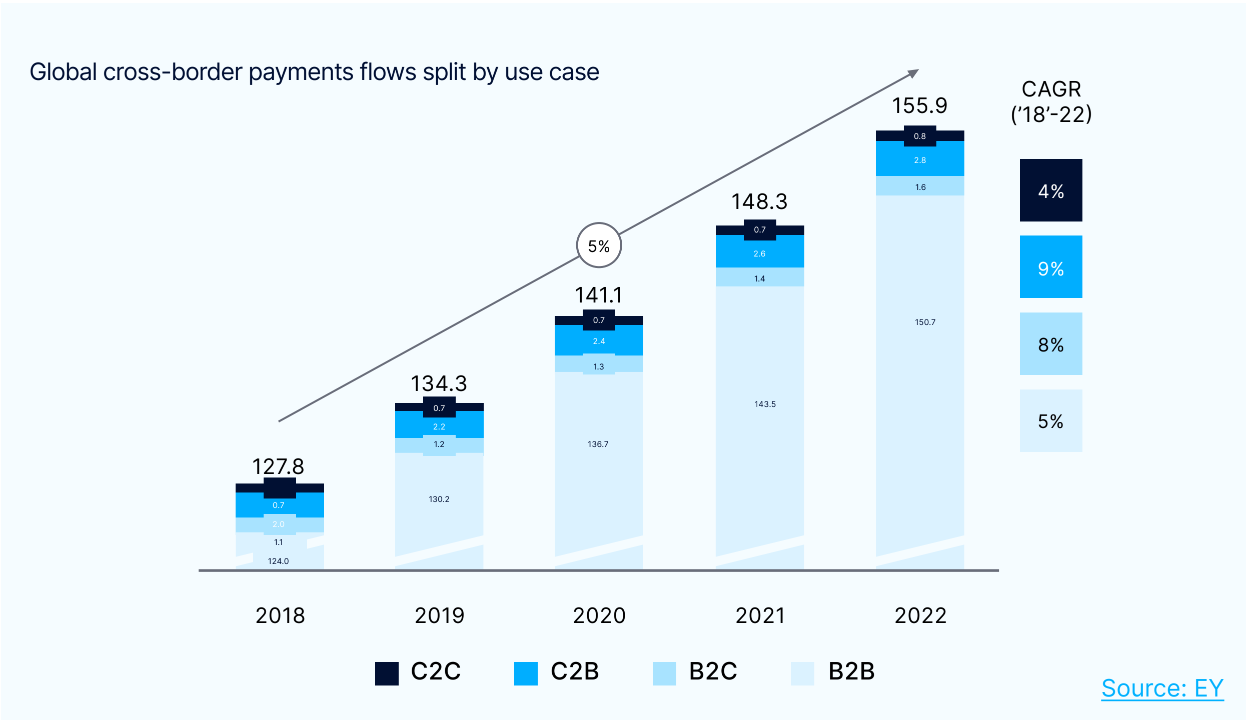
of bank operational costs goes towards GRC

- Fines and penalties loom large in every corner for a financial service provider. Till about Ocotber of 2021, financial institutions paid a whopping €5.8bn in fines, more than 170 fines in total for the first nine months of 2021 compared to around 120 in 2020.
- 15-20% of the cost of running a bank is eaten up by Governance, Risk and Compliance (GRC) functions, 10-15% of an average universal bank's workforce is employed in GRC, and 4-10% of a bank's revenue is spent on compliance.

To minimise these risks, most financial institutions shy away from expanding into new markets. In other words, lenders that manage the existing inefficiencies of cross border financing have a clear competitive advantage over those that don't.

Navigating the complex regulatory landscape

Historically, banks have been at the centre of the cross-border financing market - but if a typical transaction takes seven days on average and hundreds of dollars, such conditions are ripe for disruption.



Global cross-border payments are growing at 5% per annum and are expected to reach $156 trillion in 2022.

The trillion dollar market is ripe for disruption by FinTechs

FinTechs are agile and armed with a modern tech stack that could potentially shift the way cross-border banking services happen.

One of the major players in the ecosystem are back-end networks that work on an aggregator model. These back-end players partner with banks or wallet providers and interact with the sending or receiving party. **By establishing a direct relationship with local banks in liquid and illiquid markets, these aggregators enable interoperability within the cross-border financing ecosystem.**

Take PayPal for instance - it can transfer a deposit in Euro to an M-Pesa account in Kenia-Schillling. A Correspondent Banking Network (CBN) won't be able to do that, unless they partner with back-end networks.

An aggregator model for payments will reduce cost and enable real-time visibility as back-end providers typically require pre-funding of their sending partner as collateral. However, these aggregators are expected to be a win for low-value transactions and not B2B transactions with high working capital requirements.

That being said, cross-border back-end networks are highly scalable, and the market generally shows ‘winner takes it all’ characteristics. The emergence of regional aggregator champions and a significant increase in collaborations between banks and Money Transfer Operators (MTOs) and these aggregators, will drive the disruption.

Embedded regulatory software

Digital cross-border financing solutions need to be effortless and straightforward. That means relevant regulations must be fully transparent and lenders need to have control over the applicable rules.

In practice, that would look like an app with instant access to market-specific information - one that answers complex regulatory questions and provides advice on navigating legal, compliance, risk, and tax issues.

Open banking system

Open banking has gained popularity because it’s fulfilling a need. It cuts out the middleman and passes on the cost-saving to the end consumer. For instance, a $10,000 transaction overseas, ends up costing an additional Rs 15,000-18,000 under various headings like currency rate mark up, convenience fee, nostro charges, etc.

Open banking effectively cuts out the intermediary by connecting directly to the receiver’s bank account to verify identity, establish creditworthiness, and if needed, accept payment. Fewer players in the chain mean lesser money spent.

The P27 initiative in the Nordic region, for instance, is integrating 27 mn inhabitants across four countries and currencies into one ‘domestic’ instant payments system. P27’s open-access infrastructure enables swift real-time cross-border payments in Nordic currencies and the Euro, at low costs.

The bottom line

You want to make it as easy as possible for customers to pay you. The more options you offer, the more customers you'll convert. Think about domestic payments in India - for as long as millennials remember, payments have been a breeze. The fact that most people don't know or care about what goes on behind a UPI or IMPS payment, is the truest testament of success - they're inconspicuous and invisible. However, an average person transacting across borders will know what 'reason code', SWIFT, Form A2 are.

Part of the problem is genuine - INR is only partially convertible, unlike the US dollar. Indian Corporates have an LRS* limit of $250k - making currency hedging a cumbersome process. But regulation has the power to fix it.

There are good examples of countries that are tailoring regulations to enable FinTechs to fill the gaps in the cross-border landscape. We now have the luxury of choosing from the best practices - the fastest payment ever sent from Australia to a UK beneficiary, with confirmation of funds and credit, happened in 36 seconds. Singapore and Thailand have linked their National systems PayNow and PromptPay that allows users to instantly transfer money using only a mobile phone number.

India is the largest recipient of inbound remittances - 15% of the global share. In 2020, India received $83 billion in remittances. Over The Counter (OTC) foreign exchange instruments have a daily average turnover of about $40 billion.

We're getting there, but one step at a time. In September 2021, the Reserve Bank of India (RBI) elected eight entities for the second cohort of regulatory sandbox on cross- border payments. This is expected to spur innovations capable of reinventing the cross-border finances ecosystem in a secure, fast, and transparent manner.

***Liberalized Remittance Scheme (LRS)** facilitates resident Indians to remit up to USD 2,50,000 or its equivalent abroad per Financial Year (April-March) for permitted current or capital account transactions or combination of both

Author's Bio

Rajat Deshpande,
Co-Founder and CEO, FinBox

Rajat is a FinTech specialist and a startup enthusiast who started FinBox along with his co-founders with a mission to lay out digital infrastructure for alternate finance solutions. Under his leadership, FinBox has built multiple products in the Embedded Finance and Big Data credit analytics spaces. FinBox has enabled over 16 million lending decisions in India and SE Asia. In his prior stints, Rajat was associated with the global consulting firm ZS, Citigroup, and GoPigeon Logistics as Head of Product.

He holds a Dual (BTech+MTech) degree in Mechanical Engineering from IIT, Bombay.

Anant Deshpande,
Co-Founder, FinBox

Anant is a co-founder of FinBox. At FinBox, Anant leads lending and builds credit origination systems powered by alternate data and traditional data.

In his earlier role at Home Credit, he drove Big Data-based loan underwriting of a $2 billion consumer loan portfolio. Anant has previously been associated with global consulting firm ZS Associates and TransOrg Analytics where he owned P&L and productised analytical consulting. He is a regular marathoner and holds a BTech in Chemical Engineering from Nagpur University.

Aparna Chandrashekar,
Content Specialist, FinBox

Aparna is a Content Specialist at FinBox focused on building thought leadership, long form content, and videos. Prior to FinBox, she was a journalist involved in disseminating news across formats, with a specialisation in TV journalism. She's worked with Reuters, ET Now, and India Today as a reporter, writer, producer with a focus on business and policy. She holds a degree in Economics from NMIMS University and a post-graduate diploma in journalism from the Asian College of Journalism.

At FinBox, we are building the digital credit infrastructure and risk intelligence suite of the future. We provide full-stack API and SDKs for businesses to embed credit products into the platforms, and connect them with a diverse network of lenders. Our risk-intelligence offerings work seamlessly to improve conversions, onboarding experiences, as well as overall NPS for a variety of digital credit products run by large lenders across the world.

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