CPA Practice Advisor

account, the bank instructs an intermediary bank to act as a "middle man" to pass on the funds on their behalf. Funds can transfer between multiple intermediaries ...

Oct. 01, 2019

By Alyssa Callahan.

Whether you are initiating electronic international payments through a fintech solution or buying physical currency, the chances are high that a bank will be involved. The relationship between banks, as well as the role of intermediary banks, often eludes the general public, who are content with the process as long as it works.

However, understanding how the sausage is made can provide valuable insight into

with all the others, so instead, they strategically choose where to open accounts. The result is a fragmented network of financial institutions.

When a bank needs to send money to a location where their bank does not hold an account, the bank instructs an intermediary bank to act as a “middle man” to pass on the funds on their behalf. Funds can transfer between multiple intermediaries, especially if one of the banks is not networked with many larger banks. If the payment bank is across an international border, the intermediary bank may also act as the currency exchange provider.

The Role of Currency Exchange

Currency exchange refers to the use of one currency to purchase the same value in another currency. It’s required any time one entity wishes to pay another in a currency different from their default option.

Each country has either a “fixed” or “floating” exchange rate. A “fixed” exchange rate—also known as the “gold standard”—means that all the country’s money has a physical equivalent in gold or another precious material. “Floating” exchange rates may not have a physical worth, but are influenced by the market and politics, as is currently the case with the Great British pound’s relationship with Brexit.

Breaking Down the Cost

For businesses, currency exchange is vital to a true international payment process. Some vendors may wish to be paid in their customer’s default currency, which would not warrant an exchange. U.S. businesses may experience this when working with vendors in countries like China or Japan, who often prefer payments in USD. This happens when a vendor finds it cheaper to open accounts specific to currencies other than their own in order to avoid exchange fees.

Some vendors have opened multi-currency accounts, which enable vendors to accept

shifting, so the exchange will also gain value at times. The more international payments you make, the likelier that this cost will even out over time.

2. Intermediary bank fees. Some intermediary banks shave off a fee for their services, which is usually taken from the sum – the net amount is deposited into the vendor’s account. Not all intermediary banks will charge this fee, and it’s not immediately obvious which banks will do so.
3. Payment bank fees. Similar to the intermediary banks, certain payment banks also charge a fee for processing international payments. Again, not every bank charges this fee, but those that do will deduct it from the payment sum before depositing the net amount into the vendor’s account. Vendors can discuss this charge with their bank if it occurs.

Disrupting the Status Quo

With all these nuances to keep in mind, it can feel like involving a fintech will only add another cog to an already-overwhelming process. However, a fintech can determine the most efficient route through an intermediary bank, and assist in locating missing payments. If funds are returned for any reason, fintechs also act as a holding account while you decide if you want to exchange the funds back or resend them. Following a process like this ultimately saves time, money, and hassle.

If you’re on the fence about using a fintech for international payments, keep in mind that you aren’t losing out by mitigating an overly complicated bank processes. You’re merely side-stepping the complications in favor of usability.

———

Alyssa Callahan is a Technical Marketing Writer at Nvoicepay. She has four years of *experience in the B2B payment industry, specializing in cross-border B2B payment*

Sponsors.