

Australian Competition and Consumer Commission
forex@accc.gov.au

Dear Sir/Madam,

We welcome this Inquiry into foreign currency conversion services.

TransferWise is a money transfer start-up with a mission to bring fairness and transparency into our sector. This market is dominated by banks whose practices are dishonest and unfair, designed deliberately to boost their profits.

We have set out in this submission some information related to pricing, costs, the nature and extent of competition, as well as how prices are communicated to customers. We hope this is helpful to your Inquiry and we are happy to assist further if you have any questions. In addition to this submission, we have attached a separate folder containing spreadsheets with data collated on historical exchange rate markups levied by banks, in case this is helpful for your Enquiry.

Kind regards,

[REDACTED]

Head of Banking, TransferWise

[REDACTED]

(1) Introduction

Australian consumers making international money transfers lose an estimated \$3.1 billion a year consumers annually in hidden fees¹. The up-front fee advertised by banks is a small portion of the total cost -- the rest is generated in exchange rate markups². Most consumers do not understand this and therefore cannot compare the total costs between providers³: the table below illustrates the problem.

Provider	Exchange rate	Cost of rate mark-up	Disclosed transfer fee	Amount received (GBP)
Reuters	0.5995	N/A (this is a reference rate for comparison, not a transfer provider)		599.50
TransferWise	0.5995	0	6.95	595.33
ANZ	0.5699	\$51.90	18	569.92
CommBank	0.5667	\$ 57.77	22	566.73
NAB	0.5701	\$ 51.53	22	570.09
WestPac	0.5642	\$ 62.39	20	564.23

This problem has existed for many years, and although the hidden fees are especially egregious in Australia, they are also high in many other countries including across the EU, which is planning to take action⁴. The proposed mechanism is an extension to an existing regulation (the Cross Border Payments Regulation) that would force all foreign exchange providers in Europe to transparently disclose exchange rate margins in a single total cost figure. The European Parliament is currently debating the issue and is due to vote on the matter on the 5th November, following which it will move into the final policymaking stage known as 'trilogue'.

¹ See Appendix 2, Capital Economics

² See Appendix 1 for a worked example of this.

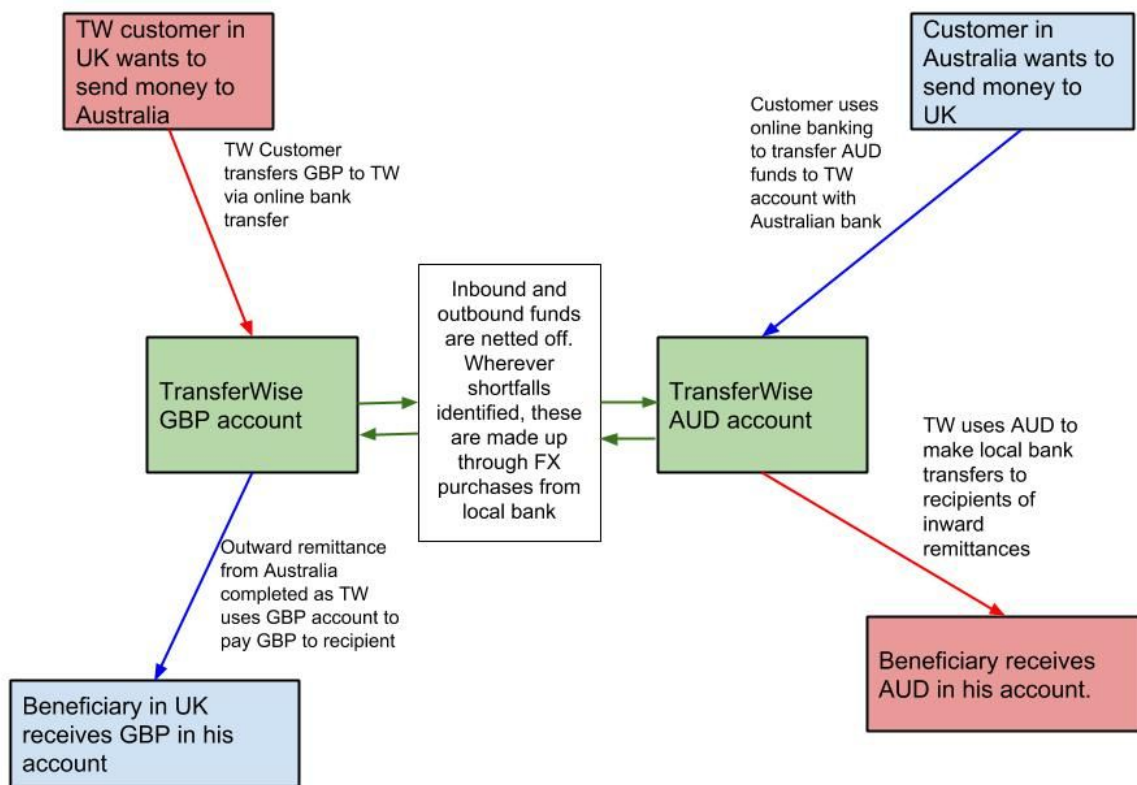
³ The Behavioural Insights Team proved through a Randomised Control Trial that the pricing methodology used by the banks is poorly understood by consumers and demonstrated that full disclosure of the exchange-rate margin .

⁴ https://ec.europa.eu/info/publications/180328-proposal-cross-border-payments_en

(2) Our operating model

The model we use to send money to and from Australia is set out in the funds flow diagram below. We move money around the world by collecting it through local payment systems in the sending country, and paying it out through the local payment system in the receiving country. Where the flows fund in both directions, we obtain some efficiencies through netting the funds, but this is not necessary for the model to operate as we can simply purchase the foreign currency we need on the wholesale market.

TW flow of funds



This has become a common operating model in the money transfer industry. The alternative method is to use correspondent banking networks for delivery of funds. Banks can use either model, with some of the different implications summarised below.

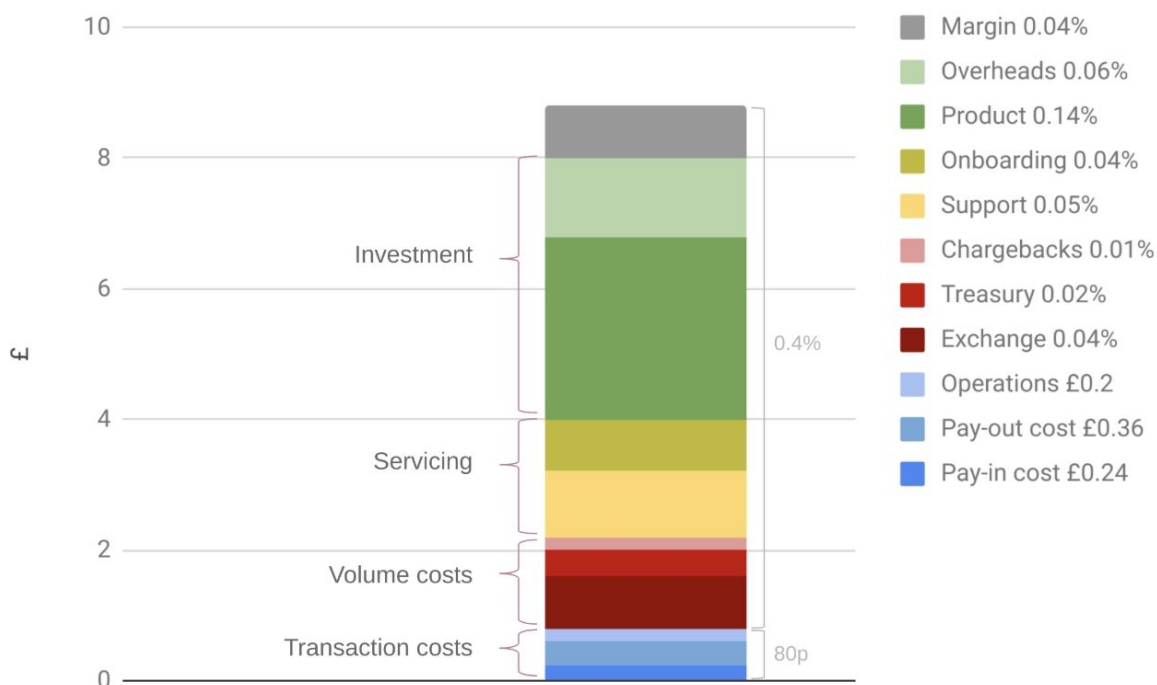
(i) Local banking model

- Need to open and maintain a series of local bank accounts around the world
- Speed of delivery is dependent on the local payment systems at both ends of the transaction
- Cost of delivery is dependent on the cost of accessing the local payment system at both ends of the transaction

(ii) Correspondent banking network

- Need to build and maintain a series of bilateral agreements with relevant banks around the world
- Speed of delivery is dependent on the systems of intermediary banks (e.g. manual processing can cause delays at each bank)
- Cost of delivery is dependent on the commercial arrangements of the intermediary banks (e.g. fees can be extracted by multiple banks involved in processing the transaction)

Our aim is to drive down the cost of international money transfers⁵. In the Issues Paper you requested information about fixed versus variable costs. A diagram is provided below setting out our fixed and variable costs for a £2,000 transfer from the UK, which has a directly comparable cost structure to our Australian business. Our pricing is designed to cover costs, with a small margin added on top. In this case the price to the consumer was 0.4% + £0.80, compared to our costs of 0.36% + £0.80.



It is worth noting that in most jurisdictions, including Australia, regulators set standards that all participants - whether banks or not - must follow in conducting the same type of activity. This is known as activity based regulation: certain types of rules apply for the activity of making payments (anti-money laundering, for example) and these apply equally to all players carrying out the relevant activity. Banks do have regulatory requirements that do not apply to non-banks, such as capital requirements, but this is because these arise from other activities (primarily lending) that create additional risks that non-banks do not create. Therefore there are no fundamental reasons why the

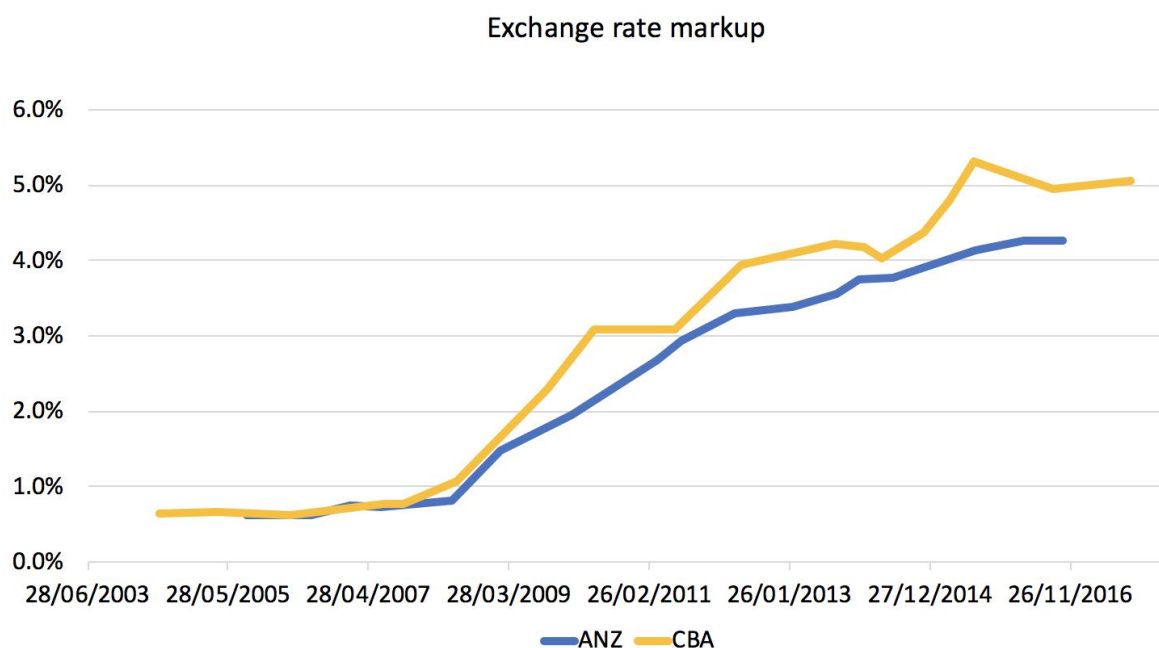
⁵ <http://kaarmann.com/why-transferwise-has-fees/>



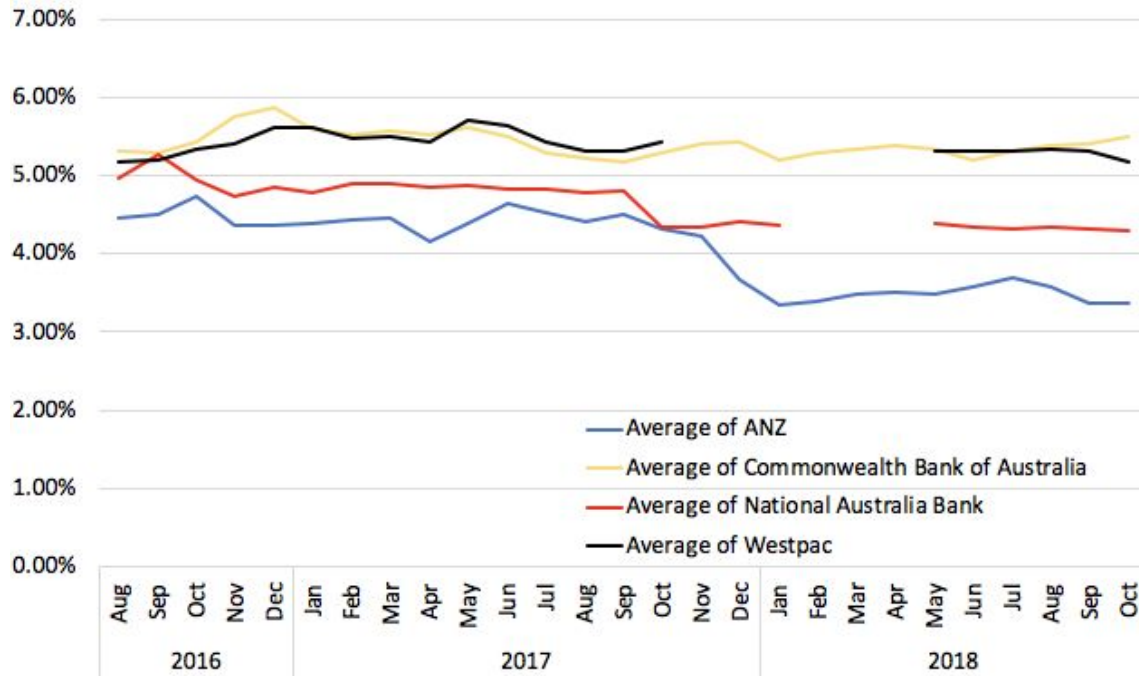
structural costs related to compliance (covered primarily in Onboarding, Product, Operations, and Support in the above diagram) should differ between participants. Cost differences are best explained in differences in efficiency of operations (e.g. better use of automation and technology can reduce costs).

(3) Competitive landscape

Banks used to offer much lower exchange rate markups than they offer now. In the early 2000's markups were below 1%. The spread has been increasing since 2007/8 and has increased by more than 600%, settling around 4-5% from the mid-market rate. This can be demonstrated by the below chart showing ANZ and CBA's exchange rate markups over time. It is also notable that the markup levied by Australian banks is now over double the equivalent transaction made by banks in the UK, Germany, and Spain⁶.



Today Westpac and CBA have higher exchange rate markups for sending Australian Dollars to US Dollars than ANZ and NAB as shown in the chart below. It can be seen that NAB slightly reduced their exchange rate markup in Sep 2017 and ANZ in Dec 2017. All of the four biggest banks are now charging a markup in the range of 3.5-5.5%. The detailed data and methodology underpinning these calculations can be found in our separate data submission.



(4) Barriers to entry

There are two major barriers to entry in this market, that allow banks to sustain supernormal profits.

(1) Lack of transparency

As demonstrated by Behavioural Insights Team, the way that banks hide costs in an exchange rate margin makes it hard for consumers to compare alternatives. As noted in the paper, one or two players using a transparent method is not sufficient to significantly alter consumer behaviour. The best way to improve consumer understanding, and therefore promote switching and subsequently effective competition, is for all participants to use the same, transparent method. As set out in the paper, this would be achieved by forcing all players to include the cost of exchange rate markups (compared to a reference rate such as Reuters) when summarising their total fee.

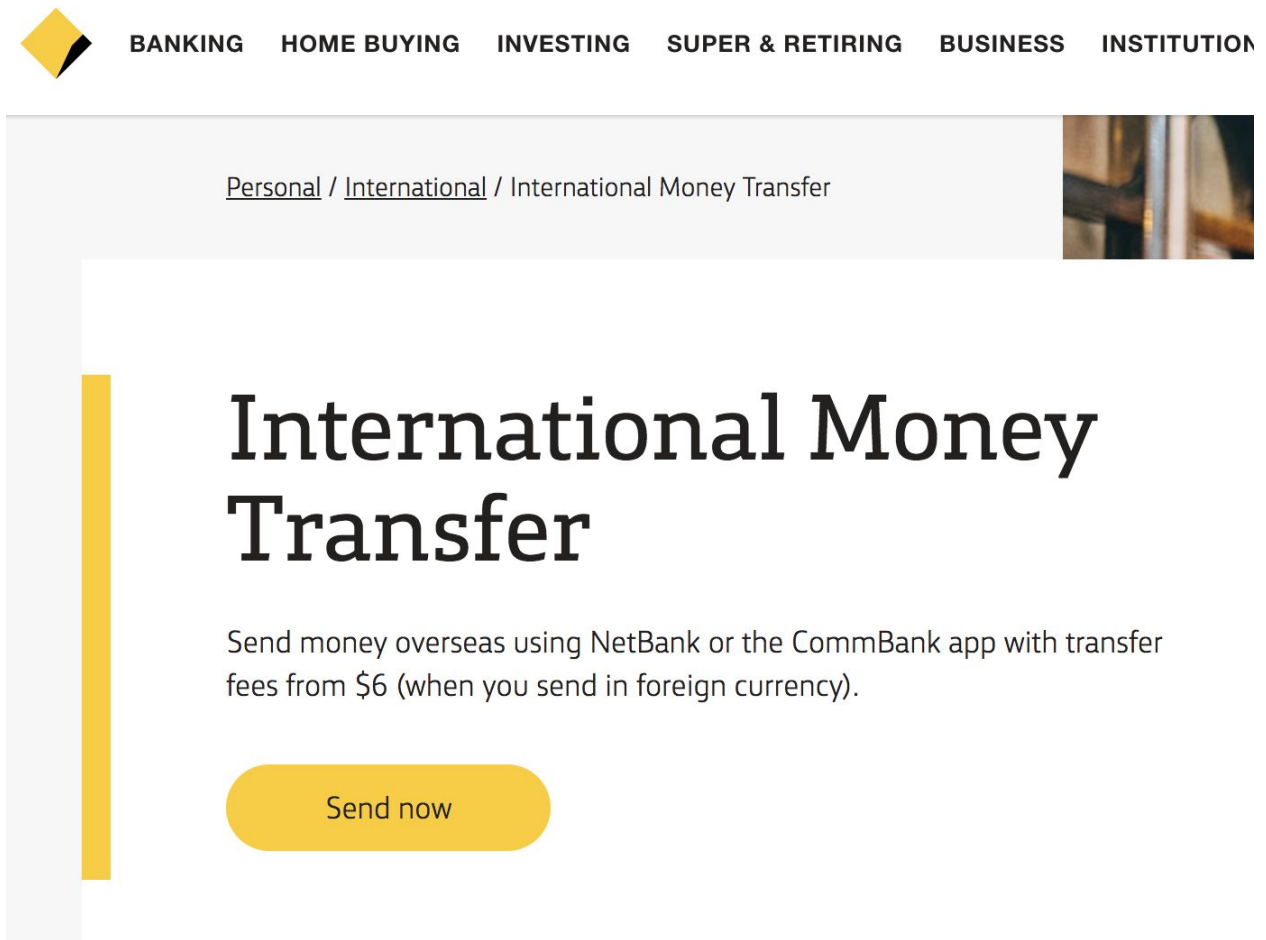
(2) Access to payment systems

Potential competitors in the market face the issue of de-risking from banks. This is the phenomenon whereby banks deny services to sectors of the economy, including the money remittance sector, due to perceived money laundering risks exceeding the banks' risk appetite. As a result, potential challengers incur significant costs in establishing and maintaining sufficient access to payment systems. They also effectively become price-takers with regards to these services, further raising their costs in relation to their competitors (the banks).

Under current payment system rules, only Authorised Deposit-taking Institutions (ADIs, otherwise known as banks) are able to participate directly in the payment system. In addition, as noted by the Productivity Commission⁷ new participants face substantial financial costs in joining, which acts as a further barrier to entry. Until it is made easier for regulated payment companies to join NPP directly, the de-risking issue is unlikely to be resolved, and potential competitors will continue to face issues of access to payment systems, which act as a barrier to entry.

⁷Recommendation 17.7

<https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.pdf>

Appendix 1: Screenshots from providers of money transfer services
Fig 1.1


BANKING **HOME BUYING** **INVESTING** **SUPER & RETIRING** **BUSINESS** **INSTITUTION**

[Personal](#) / [International](#) / International Money Transfer

International Money Transfer

Send money overseas using NetBank or the CommBank app with transfer fees from \$6 (when you send in foreign currency).

Send now

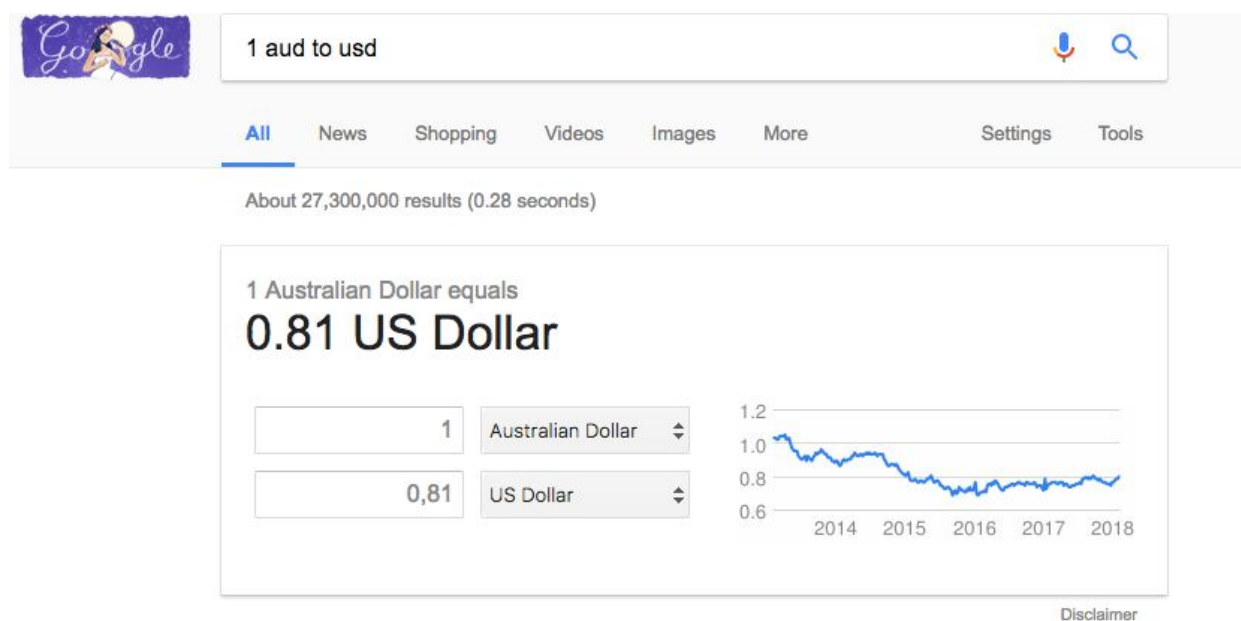
Fig 1.1 is a typical example of the advertising used by all the major banks in Australia. The transfer fee is cited as a fixed \$6 cost. A typical consumer would form a reasonable expectation that this represents the full cost of the transfer, as our evidence shows (see Appendix 2).

Fig 1.2
Amount

Transfer amount	<input type="text" value="1,000.00"/> AUD	=	Recipient's currency	<input type="text" value="770.10"/> USD	Exchange rate 1 AUD = 0.7701 USD Or enter a promo code
Transfer fee	AUD 6.00			You're paying lower fees by sending in foreign currency	
Total amount	AUD 1,006.00				2018-01-29 15:51
You're sending	USD 770.10				

Fig 1.2 shows a transfer of 1,000 AUD with CommBank, as shown to a customer (timestamp has been added to allow exchange rate comparison). As noted elsewhere in CommBank's advertising, there is a fixed fee of \$6 applied. The exchange rate is quoted to four decimal places, but there is no explanation as to how this rate is arrived at. The typical benchmark used by banks for exchange rates is the inter-bank spot market, which is also available through Google for comparison purposes. Fig 1.3 shows the spot rate for the same time that CommBank quoted 1 AUD = 0.7701 USD. This rate implies a further cost of USD 39.90 in the exchange rate mark-up that is levied by CommBank⁸. The majority of customers are unaware of this additional cost and the fact that it varies significantly between providers.

Fig 1.3



In Fig 1.4 (screenshots taken on a different day, therefore rates are different) we share a proposed, more transparent solution. Here a customer would be made aware of the \$6 fixed fee, as well as the exchange rate mark-up, by reference to a commonly accepted benchmark rate. We note that steps towards this more transparent approach have already been taken by Barclays Bank in the UK, demonstrating that it is entirely practical and possible for major banks to implement a more transparent solution⁹.

⁸ The additional US dollars that would be earned if the customer had been provided with the benchmark rate can be calculated by the amount sent in AUD multiplied by the gap in the AUD-USD exchange rate: $1000 * (0.81 - 0.7701) = 1000 * 0.0399 = 39.90$

⁹ See here <https://transferwise.com/gb/blog/barclays-leads-the-way-for-transparency>

Fig 1.4

Today

Payment details

From

Amount

USD (US Dollar)

1,000.00

Exchange rate 1 AUD = 0.7367 USD

[Or enter a promo code](#)

= AUD (Australian Dollar)

1,357.40

You're sending: USD 1,000.00

Amount: AUD 1,357.40

Transfer fee: AUD 22.00

Total amount: AUD 1,379.40

Required w/ transparency law

Payment details

From

Amount

USD (US Dollar)

1,000.00

Exchange rate 1 AUD = 0.7367 USD

[Or enter a promo code](#)

= AUD (Australian Dollar)

1,357.40

Amount: AUD 1,357.40

Transfer fee: AUD 22.00

Total amount: AUD 1,379.40

Benchmark rate: 0.78030

Bank rate: 0.73670

Benchmark amount: USD 1,043.60

Exchange rate markup: USD 43.60 / AUD 55.88

Total cost*: 77.88 AUD

You're sending: USD 1,000.00

Appendix 2: Survey data & research

(i) Galaxy Research survey of 1,004 Australians (December 2017)

Galaxy Research designed a questionnaire which was aimed at finding Australia's views on three areas:

- Living abroad
- Immigration
- Transferring money overseas

This study was conducted online among a representative sample of respondents aged 18 years and older. The sample comprises 1,004 respondents, distributed throughout Australia including both capital city and non-capital city areas. The data was weighted by age, gender and region to reflect the latest population estimates.

Each question was analysed by a series of a dozen demographic variables. The main findings related to transferring money overseas were:

- One in three Australians (35%) have transferred money overseas.
- Australia's banks lack transparency. Only one in five Australians (20%) understand that when transferring money overseas through a bank they pay an upfront fee and an exchange rate mark-up. Many (18%) think there is just an upfront fee or have no idea how banks carve out a margin (47%).
- Only 28% of those that have experience in transferring money overseas actually understand how the banks actually generate revenue - that banks add a margin to the exchange rate in addition to the upfront fee they disclose.
- More than one million Australians believe the banks provide money transfers overseas as a free service.
- Among those born outside of Australia, around half (49%) have transferred money overseas. The main reasons for transferring money overseas are family and friends (57%), in exchange for goods (34%) and travel related expenditure (20%).
- The most popular way to transfer money overseas is through a bank (67%). Others have used Western Union (29%) or else online transfer services such as TransferWise (17%).

(ii) Capital Economics analysis of consumer detriment (August 2017)

Capital Economics carried out a study into the costs of exchange rates for money transfers and card payments overseas.

Key Findings

Australian consumers and businesses spent A\$3.9 billion on foreign currency fees in 2016, of which over A\$3.1bn was in exchange rate mark-ups and card spending charges applied by banks and currency brokers to international transactions.

This equates to a loss of \$167¹⁰ in fees to banks and brokers for every Australian adult in 2016 or \$513 for each family.

Between 2012-2016, Australian consumers & businesses have spent over A\$14.7bn in fees on foreign currency transactions. As the world becomes more global this figure is increasing year on year.

Impact on Consumers

In 2016, Australian holidaymakers and work travellers paid \$1.1 billion in fees for exchanging currency.

This figure includes more than \$110 million in exchange rate markups on cash exchanged before travelling overseas, more than \$930m in exchange rate markups and fee charges applied to card purchases abroad, and almost \$170 million in charges for overseas cash withdrawals.

On average, \$180 is spent on exchange rate markups and card fees for every trip abroad taken by an Australian.¹¹

Impact on Businesses

The impact on Australian businesses in 2016 was large as well. Australian businesses importing and exporting goods and services paid A\$1.5 billion in rate markups in 2016 alone. Just A\$15m was advertised to these businesses in upfront transaction fees. Small and medium enterprises in particular paid almost \$150m in exchange rate markups on exports - 150 times more than the \$1m advertised to them in upfront fees.

Impact on Remittances

Remittance outflows from Australia totalled \$9.8 billion in 2016. Remitters paid nearly \$220 million in rate markups in 2016. Over the past five years they have paid a total of almost \$960 million.

Methodology

This research was conducted by independent consultancy Capital Economics, commissioned by TransferWise in June 2017. It estimates the fees paid by consumers and businesses on foreign exchange transactions each year in Australia from 2011 to 2016 in four areas:

1. Spending by Australian consumers abroad – covering holidays, business trips and visits to friends and relatives

¹⁰ Population aged 18 and over = 18.771m

¹¹ <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4102.0Main+Features20Sep+2010>

2. Trade in goods and services – small and medium sized enterprises and large businesses import and export goods or services

3. Remittances from Australia – workers pay fees when they send money to family or friends who live abroad

4. Portfolio investment earnings abroad

Overall Summary

Fees (\$ million, current prices)						
Fees on remittance outflows from Australia	2011	2012	2013	2014	2015	2016
Total fees	714	785	804	740	858	883
<i>Of which, exchange rate margins</i>	157	173	185	169	213	219
<i>Of which, fixed transaction fee</i>	557	613	619	571	645	664
Fees on portfolio investment earnings from abroad	2011	2012	2013	2014	2015	2016
Fees on income from equity	83	90	101	120	139	151
<i>Of which transaction fees</i>	19	20	23	27	31	34
<i>Of which exchange rate margins</i>	64	70	79	93	108	117
Fees on income on debt	85	68	65	67	66	62
<i>Of which transaction fees</i>	19	15	15	15	15	14
<i>Of which exchange rate margins</i>	66	53	50	52	51	48
Fees on consumer spend abroad	2011	2012	2013	2014	2015	2016
Total fees	1 036	1 078	1 121	1 154	1 150	1 221
<i>Of which on spending by businesses</i>	152	161	175	164	159	160
<i>Of which on spending by households</i>	883	917	946	991	991	1 061
Credit and charge card purchases abroad	392	422	454	484	498	546
Debit card purchases abroad	236	265	295	325	344	388
Cash withdrawals abroad using credit or debit cards	197	194	190	184	171	169
Cash exchanged in Australia	211	197	181	162	136	117
<i>Of which exchange rate margins</i>	204	191	176	157	132	114
<i>Of which transaction/upfront fees</i>	6	6	5	5	4	4
Trade	2011	2012	2013	2014	2015	2016
Exports by large businesses	631	632	680	699	750	758

<i>Of which exchange rate margins</i>	625	626	674	693	743	752
<i>Of which transaction/upfront fees</i>	6	6	6	6	7	7
Exports by SMEs	121	116	124	147	142	147
<i>Of which exchange rate margins</i>	120	115	123	146	140	146
<i>Of which transaction/upfront fees</i>	1	1	1	1	1	1
Imports	568	595	620	644	668	635
<i>Of which exchange rate margins</i>	562	589	613	637	661	628
<i>Of which transaction/upfront fees</i>	6	7	7	7	7	7
Total	2011	2012	2013	2014	2015	2016
<i>Of which exchange rate margins and fees on using cards abroad</i>	2 624	2 697	2 838	2 938	3 061	3 127
<i>Of which transaction/upfront fees</i>	615	667	676	632	711	731
Total	3 239	3 364	3 514	3 571	3 772	3 858