Cross-Currency Payments and SWIFT

We have so far been talking about payments involving one currency, be it US dollars, euro or Japanese yen. International trade and mobile individuals increasingly demand payments to be effected to settle debts in a different currency than that in which the initiator holds his account, for instance a Japanese manufacturer invoicing a US importer in yen. These used to be called ‘international payments’ or ‘cross-border’ payments, but since the advent of the euro which is now the legal currency in 15 of the EU countries, it is more correct to distinguish between cross-currency payments for our example above and cross-border payments when creditor and debtor are located in different countries but the payment is in a common currency – for instance a euro payment between euro accounts in the Netherlands and Spain.

Generally speaking, ‘currencies do not travel’: the settlement of payments in a given currency takes place at the central bank which issues it. A presence in the country of the currency is therefore required. Credit cards which can be used outside their country of issue are the payment instrument most used by individuals when travelling or ordering goods from abroad (see ch. 2 sec. 6), but credit cards are a relatively new instrument and not suitable for commerce or financial markets. Cheques can be presented abroad, but the beneficiary would have to wait a long time before his account is credited as the cheque has to be recovered: physically (before the advent of electronic imaging and transmission) sent back across the oceans to the drawer’s bank to verify the signature and availability of funds.

1 Correspondent banking

To satisfy the demand for international payments, banks developed the system of correspondent banking, opening accounts in the local currency
with each other, called *nosto accounts* (from the Italian ‘nosto’ meaning ‘our’).

Figure 3.1 illustrates the case of a Belgian supermarket chain ordering Angus beef from a Scottish cattle farmer, who invoices it for GBP 10,000. The debtor's Belgian bank will convert the £10,000 into euros at the prevailing exchange rate (say €13,550), credit his British correspondent’s nostro account in euros and debit the supermarket’s account by the same amount plus charges. He will instruct the British bank to credit the farmer's account with GBP 10,000, which the British bank will first debit from the Belgian bank’s nostro account.

This case is relatively simple in the sense that the Belgian bank’s correspondent, also referred to as its sterling *clearer*, happens to also be the Scottish farmer’s bank. This is not always the case as banks normally only entertain correspondent relationships with only two or three correspondents per currency. We can well imagine that the farmer will hold his account with a bank in Edinburgh which will not be the Belgian bank’s clearer in the City.

In this case (see Figure 3.2), the Belgian bank will:

- Instruct the Scottish bank to credit the farmer, indicating that *cover* will come from his named sterling correspondent;
- Instruct his correspondent to credit the beneficiary’s bank with the £10,000, which will be effected through the UK clearing and settlement system.