On reducing remittance costs

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Abstract

High fees charged by remittance service providers is a major challenge for policy makers interested in facilitating international migrant remittance flows to developing countries. This paper discusses some of the factors that influence the price of remittance services. Drawing on conversations with some remittance service providers, this paper argues that remittance services should be recognized as a self-standing industry separate from banking services. That would help efforts to simplify and harmonize regulations relating to remittances, thereby encouraging competition in the remittance market. Improving access of smaller remittance service providers such as credit unions and larger microfinance institutions clearing and settlement systems would also help improve competition and reduce remittance costs. Finally, improving the access of undocumented migrants to formal remittance channels, especially banks, would have a significant impact on remittance costs and also on discouraging the use of informal channels.

I Introduction

Estimated at over $140 billion in 2005, migrant remittances are an important source of external finance for developing countries.[1] Yet, high costs of sending remittances often in the range of 10 to 20 percent are a major drain on these resources.[2] In this paper we report findings from discussions held with some major remittance service providers[3] on the factors that influence the price of remittances to developing countries. The topics discussed included the number of competitors in a given market, the size of remittances in a given corridor, the costs to providers, regulations, consumer alternatives and awareness. The main findings are the following:

- Remittance services need to be recognized as a self-standing industry separate from banking services. The regulations governing remittances should be harmonized within countries, between countries, between banks and remittance companies providing the same service, as well as for sending and receiving countries
- In a number of markets, prices to consumers are high due to lack of competition and restricted access of some consumer categories to existing remittance services.
- Credit unions and smaller financial institutions could play useful role in channeling remittances, but they do not typically have access to national clearing and settlement systems.

The plan of the paper is as follows. The next section describes the remittance industry in terms of countries sending or receiving transfers, the players in these remittance markets and the different technologies used. The third section focuses on remittance fees and costs, and factors that affect them. Finally, the fourth section contains some policy recommendations.

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[1] World Bank, Global Development Finance 2005

[2] Manuel Orozco, *Market, money, and high costs,* February 2002

[3] Interviews and meetings were conducted with Bancomer Transfer Services, Dolex, First African Remittances, ICICI, Ria Envia, SafeSend (Bank of America), State Bank of India, Vigo, Western Union and the World Council of Credit Unions. We want to thank all interviewees for their valuable inputs and insights.

II The Remittance Market

The biggest players in the remittance markets are traditionally companies that specialize in remittances, as opposed to banks, who offer remittances as one of many products in their portfolio. Exact data on how much money different banks and money transmitters move in a given year is very hard to come by, especially as banks rarely single out volumes by product categories. The single largest player is Western Union. First Data Corporation, its parent company, stated in its 2003 annual report that Western Union remitted about $ 21 billion in 2003[4]. Other significant players in the market are MoneyGram International, estimated at between $ 4 billion and $ 5 billion remitted principal in 2003[5], as well as Vigo at roughly $3 billion[6]. Global banks play a minor role in remittances. [7]

An attempt at collecting the names of all remittance companies and banks offering a specific remittance product resulted in a list of 298 remittance companies and 42 banks. While the variety of remittance companies was impressive and covered all remittance corridors and sizes, the banks offering a specific remittance product were generally ethnic banks associated with Mexico, India, Turkey, the Philippines and Morocco.

For the general understanding of the remittance industry, it is necessary to review the different categories of remittance companies. These different types of remittance companies differ in their network, their pricing and marketing strategies, as well as the technology used. All in all, they have different strengths and weaknesses. By asking the following questions, remittance companies can be roughly put into a limited number of categories, as shown in the table underneath:

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[4] Annual Report 2003, First Data Corporation, page 7, available at www.Firstdata.com

[5] Financial Technology Partners Transaction Profile: Overview and Performance Update on MoneyGram International's Spin-off from Viad Corp., July 2004, page 8

[6] Announcement by Great Hill Partners, March 31 2003, stating $2.5 transmitted in 2002 and an average growth rate of 30 %

[7] Dr. Manuel Orozco, The Remittance Marketplace: Prices, Policy and Financial Institutions, June 2004, page 8. A study by Dr. Manuel Orozco published in June 2004states that the four largest U.S. banks in this field – Citibank, Wells Fargo, Harris Bank and Bank of America – conduct less than 100,000 remittance transactions a month with almost all going to Mexico. An estimated 40 million remittance transactions were sent from the United States to Mexico, which mans these banks have captured about 3 percent of that market.

- Is the geographical focus of the company global, regional or a single corridor?
- Is remittance the core product of the company, or is it a side business?

Geographic focus

		Worldwide	Regional	Single/few corridors
	Sole product	MoneyGram Western Union	Bancomer Transfer Services, Dolex Giros Latino	GiroMex Small players
MT core product	**Important product**		Ria Envia Delgado	Hawala, PEKAO, Wells Fargo, Jamaica National Bank of China, Philippines National Bank, ICICI, Equitable Bank
	Side product	Citibank, Bank of America, Postal Systems, VISA	Ethnic & regional l banks Contact	Small players

This categorization calls for the following first observations:

1. All the major players are pure remittance companies and not banks. Only one remittance company (Bancomer Transfer Services) is a subsidiary of a bank.
2. Global banks only offer remittances as a side product and, despite their size, never play a significant up-front role in the remittance business. Many remittance companies have to rely on large banks to settle the accounts with the sending and receiving agents, but this is done at a wholesale level, just as any other commercial transaction.

3. The only banks to play a significant role in remittances are banks from developing countries where remittances represent a major source of foreign exchange. The most notorious banks are from India (ICICI, State Bank of India), Turkey (Esbank, Disbank, Pamukbank, Isbank and others), the Philippines (Philippines National Bank, Equitable Bank and others) or other countries like Ghana (Ghana Commercial Bank with Fast International Money Transfers). None of these banks have made any effort to service other communities than their own.

Legal frameworks

The following is an overview of the different regulations for obtaining a money transmitter license. The reader will find that there are two main schools of thought regarding remittances: first, those countries treating the remittance services as an activity that requires no license or a license purely for remittance, which could be defined as a tailor-made license. Examples of these countries are the United States, Canada, the United Kingdom and Spain. The second category of countries defines the remittance business as being one particular financial service, which requires the license of a financial institution or a bank. In countries like France, Russia and Italy, the license required for operating a remittance service is much broader than what would be required just to perform remittance services.

Table :Licensing requirements for remittance service providers				
Country	**Net worth $**	**Audited Financials**	**Bond**	**Comment**
United States[8]				
Florida	100,000 plus $ 50,000 per location up to $ 500,000	Yes	1 % of annual turnover, maximum $ 250,000. Can be set at $ 500,000 in exceptional circumstances	Fee $ 500
Massachusetts	None	No	$ 50,000 (or 2x amount of outstanding transactions)	Fee $ 250
Texas	$ 500,000	Yes	$ 100,000 for first location, $ 50,000 for each additional, maximum of $ 400,000	Fee $ 250 licensing + $ 2,500 investment fee
Illinois	Depending on locations: 1 = $ 35,000 25+ = $ 500,000	Yes	Greater of $ 100,000 or the average daily outstanding for 12 months, maximum $ 2,000,000	Fee $ 100 application $ 100 for license+ $ 10 per location
California	$ 250,000 + at least $ 250,000 in tangible shareholders equity	If available	Discretionary depending on size of business. Minimum $ 200,000.	Fee $ 5,000
New York	Liquidity equivalent to outstanding payments	Yes, 2 years	$ 500,000	Fee $ 500 license + $ 1,000 investigation.
Wisconsin	“Suitable to conduct business” Should not be lower than $ 10,000	No	$ 10,000 for 1st location + $ 5,000 for each additional. Maximum of $ 300,000	Fee $ 500 license (annual) + $ 300 investigation + $ 5 per location (annual)
Canada[9]	None	none	none	Subject to anti-money laundering regulations
France	€ 2,400,000 at a minimum, plus capital to cover first years expenses.	yes, 3 years	none	The ownership structure must be adequate. AML procedures are scrutinized.
Germany (federal legislation)	€ 125,000 capital. Net worth must be sufficient to cover exposures	yes	none	AML laws must be followed. 2 managing directors must have a suitable background.
Italy	€ 750,000	yes	none	The license is only required by the service provider, not by his agents.
United Kingdom	None	no	none	Register normal business. Moneys may not be held for more than 3 days, as a bank license (deposits) would be required in this event.

[8] Source: www.rubinsanchez.com , representing the legislations for the different States of the USA
[9] Canadian Bankers Association ; French Central Bank, Banque de France, Comité des Etablissements de Crédit et des Entreprises, d’Investissement (CECEI), Committee for Credit Institutions and Investment Companies; German Financial Supervisory Board, Bundesanstalt für Finanzdienstleistungsaufsicht; Italian Law 106; Bank of England

The following table shows the wide variation in the regulatory requirements of bonding and net worth among 30 states in the United States. To start a money transfer business with offices in all these states would require bonds and net worth of nearly $10 million.

	State	Bond Min Amt	Bond Max Amt	Net Worth Min Amt	Net Worth Max Amt
1	Alabama	$5,000	$5,000	$10,000	$50,000
2	Arizona	$25,000	$25,000	$100,000	$100,000
3	California	$200,000	$200,000	$250,000	$250,000
4	Colorado	$1,000,000	$1,000,000	$100,000	$100,000
5	Connecticut				
6	Delaware				
7	District of Colombia	$50,000	$250,000	$100,000	$500,000
8	Florida	$250,000	$250,000	$100,000	$100,000
9	Idaho	$10,000	$500,000	$50,000	$250,000
10	Illinois	$100,000	$100,000	$100,000	$100,000
11	Indiana	NA		$100,000	$500,000
12	Kansas	$50,000	$200,000	$100,000	$100,000
13	Louisiana	$25,000	$25,000	$100,000	$100,000
14	Maine	$100,000	$100,000	$100,000	$500,000
15	Maryland				
16	Massachusetts	$50,000	$50,000	$50,000	$100,000
17	Minnesota	$25,000	$250,000	$25,000	$500,000
18	Nebraska	$50,000	$150,000	$50,000	$50,000
19	Nevada	$250,000	$250,000	$100,000	$100,000
20	New Jersey	$100,000	$1,000,000	$50,000	$400,000
21	New York	$500,000	$500,000	NA	NA
22	North Carolina	$150,000	$250,000	$100,000	$500,000
23	Oregon	$25,000	$150,000	$100,000	$500,000
24	Pennsylvania	$1,000,000	$1,000,000	$500,000	$500,000
25	Rhode Island				
26	Tennessee	$50,000	$800,000	$100,000	$500,000
27	Texas	$100,000	$400,000	$500,000	$500,000
28	Vermont	$100,000	$500,000	$100,000	$100,000
29	Virginia	$25,000	$1,000,000	$100,000	$100,000
30	West Virginia	$300,000	$1,000,000	$50,000	$1,000,000
	Sum	**$4,540,000**	**$9,955,000**		

Factors determining the market structure

Role of global commercial banks

The first observation that needs to be better understood is the fact that banks only play a major role in remittances if the legislation in place limits remittance services to banks and financial institutions, as this is the case in France for instance. In countries like the United States and the United Kingdom, banks play only a minor role in remittances. Banks are then focused on some very specific markets like India or the Philippines, where the legislation in the receiving country and the important banking network prove to be a major asset.

Germany has only recently changed the legislation to allow for remittances to be conducted under a financial institution license instead as under a banking regulation[10]. Austria has now regulated the remittance companies in a manner where they need € 36,000 for LLCs and € 72,000 for incorporated companies.[11]

Several factors explain why these large banks do not consider remittances to be their core business and hence only offer it as a marginal product, if at all:

- Larger loans and investments are more profitable than small remittances.
- Remittances are mostly sent by the kind of customers the bank does not consider to be prime customers, as these are mostly low net value customers.
- From the remitter's point of view, large banks are often intimidating.
- Remittances are often sent to developing countries and rural areas, while large banks tend to be present in the more affluent countries and areas.

So in short, there is a relatively poor match between the commercial banks target customers and target geographies on the one hand and the remittance senders and receivers on the other hand.

[10] German Financial Supervisory Board, Bundesanstalt für Finanzdienstleistungsaufsicht
[11] Amendment to Austrian Banking Law, Novelle zum Bankwesengesetz, BGBl I 2003/35, in force as of Jan 1st, 2004

Role of global credit unions, micro-finance institutions and pro-poor banks

Credit unions and micro-finance banks are the kind of banks that do serve the same kind of rural, poor customers. The profit objectives of these banks are generally much lower. Credit unions in the United States are non-profit organizations. This category of banks is sometimes found in the role of agents in networks like Western Union and MoneyGram. WOCCU, the World Council of Credit Unions does operate a remittance system for its members and has expanded its network significantly by signing an agreement with VIGO.

Role of regional, ethnic banks

For developing countries, remittances are an important source of revenues. For example banks from the Philippines, India, Bangladesh, and Turkey are much more interested in offering remittance services than global banks, as their customers see remittances as a key product, in this case a source of revenue and financing in the receiving country. As an example, data published by the Bangladesh Bank in 2004[12] shows that 18 local banks have an aggregated market share of 96.4% of formal remittances, while the foreign banks only perform 3.6% of remittances. The key factors influencing this distribution are network size and customer focus. It is also worth noting that these 18 banks offer very low prices for their remittance services.

Furthermore, banks have several important assets necessary to successfully conduct remittance services:

- Branches in the home country to do payouts even at a large scale
- Trust[13] and awareness of the senders and receivers (in most cases)
- Adequate locations (safety) and enough cash to pay out
- Branch offices in the sending countries to facilitate remittances
- The necessary licenses

[12] Bangladesh Bank statistics on remittances August 2004. Note: informal remittances are not captured

[13] As an example, Russians trust their banking system little. The All-Russian Center for Studying of Public Opinion (ACSPO) published a study in 2004, where the vast majority of Russian stated to distrust commercial banks.

These regional, ethnic banks apparently almost never expand their remittance network to include other communities, even if these communities often live in the same neighborhoods overseas. The only case of regional banks cooperating in a remittance network controlled by a bank is the Contact network operated by Russlav Bank in Russia. Contact is a network with about 5500 banks in 72[14] countries, covering mainly Eastern and Central Europe, Latin America and Western Europe.

Role of pure remittance companies

Remittance services are found in virtually any country, either formally or informally organized. Remittance companies play a major role here due to the following factors:

- Most remittance companies focus solely on remittances, so they are tailor-made for these needs. If they offer other products, these are very often geared towards the same customer base (travel services, phone services, parcel services), which then gives the customers more than one reason to visit that remittance company.
- They offer locations in the cities and neighborhoods where the customers need them. These are often poorer suburbs in developed countries where the senders live, as well as cities and rural areas in the receiving countries.
- Their marketing and service is conducted in a language the customers speak.

Many remittance companies in the United States have started at the initiative of an immigrant, who initially offered a remittance service to his or her home country. In 1985 Vigo introduced its remittance service solely to Brazil and has now grown to be amongst the 5 biggest American remittance companies.

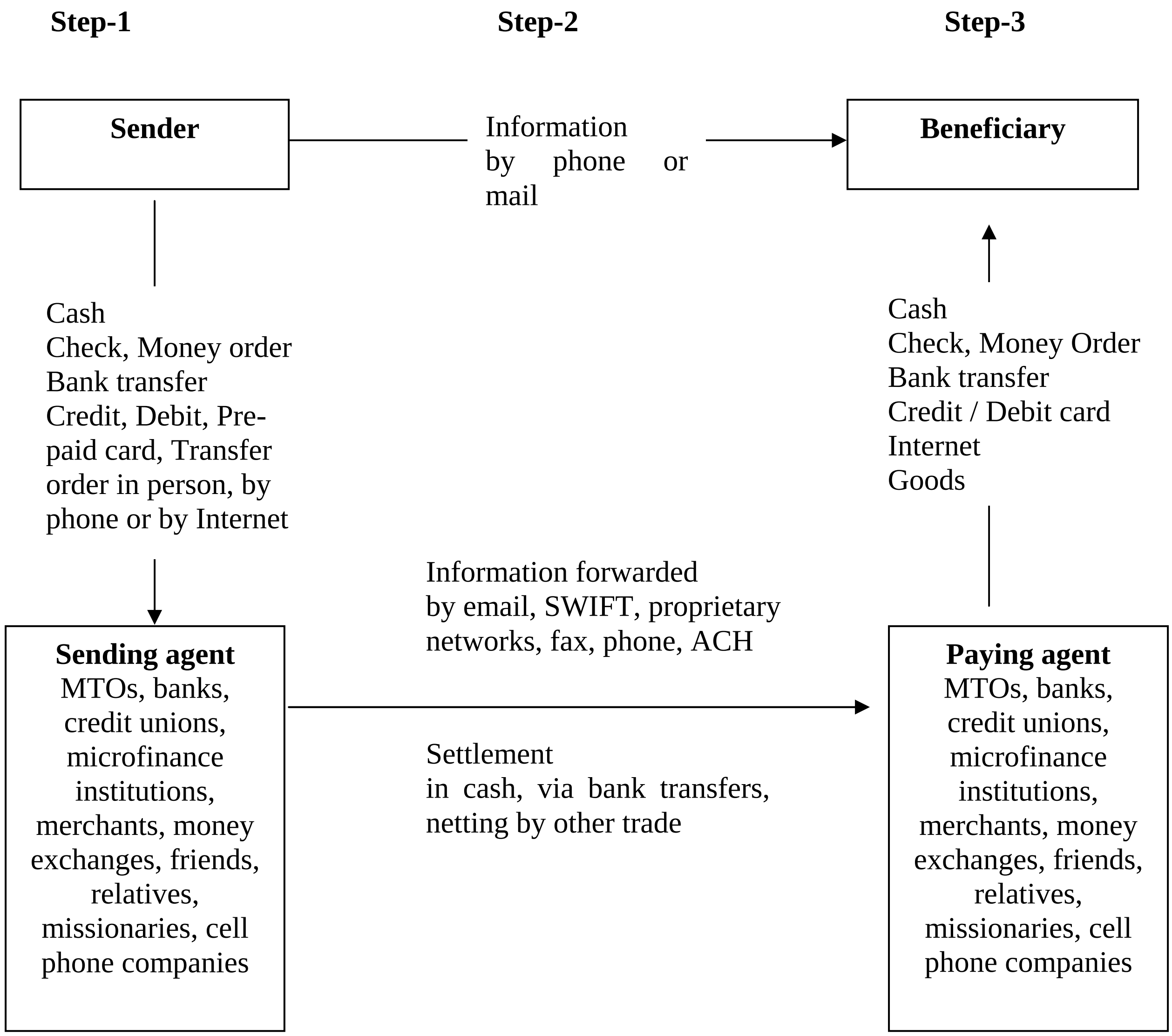
The remittance market in the United States is characterized by a few dominant players like Western Union and MoneyGram, followed by a few intermediate players like BTS, Vigo and Ria Envia. Finally there is a multitude of players that focus on a single or a few corridors and either have no desire or no means of growing into other corridors. Some of these small players offer an excellent service at low costs, and thus are able to compete with the giants of the industry on a particular corridor.

[14] http://www.contact-sys.com/eng/index.phtml

One example is First African Remittances of Maryland and Virginia offering services solely to Ghana. Interviews with this kind of single corridor remittance companies have almost every time indicated that obtaining a license is a key concern, together with the challenge of making remittances profitable as an only product, compared to banks offering remittances as a side product and not requiring a special license.

Technologies

A typical remittance transaction takes place in three steps: (1) initiation of remittances by a migrant sender using a sending agent, (2) exchange of information and settlement of funds, and (3) delivery of remittances to the beneficiary. In step 1, the migrant sender pays the principal amount of remittance to the sending agent using cash, check, money order, credit card, debit card, or a debit instruction sent through email, phone, or internet banking. In step 2, the sending agency – could be a MTO, bank or another financial institution, a money changer, or a merchant (e.g., a gas station, grocery store) then instructs its agent in the recipient country to deliver the remittance to the beneficiary. In step 3, the paying agent makes the payment to the beneficiary. In most cases, there is no real-time fund transfer; instead, the balance owed by the sending agent to the paying agent is settled periodically according to a mutually agreed schedule. The settlement is mostly carried out using commercial banks through the national clearing and settlement systems. A part of informal remittances through hawala channels are sometimes settled through goods trade.


Step-1
Step-2
Step-3
Sender
Information by phone or mail
Beneficiary
Cash
Check, Money order
Bank transfer
Credit, Debit, Pre-paid card, Transfer order in person, by phone or by Internet
Cash
Check, Money Order
Bank transfer
Credit / Debit card
Internet
Goods
Information forwarded by email, SWIFT, proprietary networks, fax, phone, ACH
Sending agent
MTOs, banks, credit unions, microfinance institutions, merchants, money exchanges, friends, relatives, missionaries, cell phone companies
Settlement in cash, via bank transfers, netting by other trade
Paying agent
MTOs, banks, credit unions, microfinance institutions, merchants, money exchanges, friends, relatives, missionaries, cell phone companies

Each remitter has his own system. Here again, it is easier to understand the remittance industry, by looking at the different options of depositing money, of transferring the information, of paying the beneficiary and of settling between the parties involved in the transfer.

Almost any combination of depositing, transferring the information, paying and settling exists. Here are some of the major methods of performing remittance services:

Many remittance companies like Western Union, MoneyGram and Vigo accept cash as the principal method of payment by the sender. The information is then forwarded by electronic means to the paying agent, who generally pays to the beneficiary in cash. The settlement for all performed transfers in a given time period is then calculated in a proprietary system and settled via a single netting bank transfer.

Banks offering remittance services tend to move money between accounts, but a large number of unbanked[15] immigrants prefers or needs to pay cash without the necessity of an account for the sender or the beneficiary. Especially in developing countries, only a minority of people have bank accounts. A report by the South African Reserve Bank[16] states that only 40 % of South Africans were banked in 2001 (28% for black South Africans), still a percentage a lot higher than the 35% registered in Brazil or 5.9% in Kenya.

Some remittance systems use debit or credit cards[17]. The amount of the remittance is credited to the card, sometimes even stored on the card. The information transfer is treated like any other credit card payment. The settlement can involve several parties, depending on how the credit is spent.

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[15] Kennickell, Arthur et al.: *Recent Changes in U.S. Family Finances: Results from the Survey of Consumer Finances*, Federal Reserve Bulletin, Vol. 86, No. 1, January 2000, pp. 1-29. This study shows that most unbanked households have an African-American or Hispanic background.

[16] South African Reserve Bank: *Financial Development and the Unbanked,* http://www.reservebank.co.za/internet/Publication.nsf/LADV/E8188843491D7ABF42256D09002746D6/$File/LMSF+Apr2003+.pdf

[17] Many of these systems are Internet based : ikobo.com, Sendwise.com, c2it.com. Some other use stored value cards like Visa Travel Money

Another method of remitting money is buying a money order, and then mailing it to the beneficiary, who then either deposits it in an account or cashes it at a check cashier, who deposits it for settlement within the bank clearing system.

Hawala[18,19], a traditional Asian remittance system works yet differently. Generally, the sender pays in cash and the beneficiary also receives cash. The information is relayed by phone, fax or email. Most interesting is the extreme simplicity of communications and settlement. Hawala grew out of trade relationships, at times where banking systems were inexistent. Even today, hawala is closely associated with trade and the settlement between two hawaladars can either be performed by single bank transfers, even in third countries, or by the shipment of any traded goods.

There are also some technologically very advanced methods of sending transfers. Remittance systems like ikobo.com essentially use the Internet as a means of transferring remittances. Other services like PayPal do not focus on immigrants to transfer money, but technically move money between virtual accounts.

This advanced technology is also being used in the Philippines, where remittances can be sent using a cell phone[20]. Many cell phones are operated by pre-paid cards, which effectively are stored value cards. In the Philippines, it is possible to use the money stored on these card in many stores. This system is very efficient, as it virtually gives beneficiaries access to their money anywhere and around the clock, as well as a multitude of ways of spending the money directly on goods. Unfortunately, in many developing countries, the necessary telecom infrastructure is not in place.

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[18] El Qorchi, Maimbo, Wilson: *Informal Funds Transfer Systems : An Analysis of the Informal Hawala Systems*, IMF, 2003

[19] Interpol has also published a very extensive description of hawala systems: http://www.interpol.int/Public/FinancialCrime/MoneyLaundering/hawala/#3

[20] Smart Money, Philippines: http://www.smart.com.ph/SMART/Value+Added+Services/Smart+Money/SM_AboutMoney.htm

Text-based remittance system by Smart Communications in the Philippines

The largest mobile phone company of the Philippines, Smart Communications has developed an innovative remittance system based on cell phones and text messaging.

In the Philippines, cell phones are widespread, as at least 30 percent of the 84 million Filipinos own one. Frequently, cell phones are used not to make calls, but to send text messages, as it is cheaper -the average Filipino only has a modest income.

Smart Communications recognized the opportunity to build a remittance product based on text messaging.

A standard remittance with Smart works the following way: a Filipino, for example in Hong Kong, deposits the money to be remitted with one of Smart's remittance partners. This partner then sends a text message to the beneficiary in the Philippines, informing him or her of the transfer. The remittance is credited into the Smart Money electronic wallet account. Any Smart cell phone holder can obtain such Smart Money account.

Smart remittance partner exist in several countries already: Travelex Money Transfer, Forex International Hong Kong, Dollar America Exchange in California, CBN Grupo in Greece, the United Kingdom, Spain, Ireland and Japan, New York Bay Remittance, Banco de Oro Bank in Hong Kong.

The money can be withdrawn from an ATM using the Smart Money as cash card. It is also possible to use the Smart Card directly for purchases, in which case the card functions as a debit card. Cell phone users can also walk into stores of Smart's partners in the Philippines to pick up cash directly. Some of the Smart partners are McDonald's, SM malls, SeaOil gas stations, 7-Eleven and Tambunting pawn shops.

The simplicity of the system allows low charges. The fees at origination vary from country to countries. In Hong Kong, the fee is about $2. In the Philippines, the charge is 1 percent plus the cost of the text notification of 2.50 pesos (4-5 cents).

The Smart remittance system not only fast, inexpensive, but also secure. The different PIN numbers for the cell phone and the Smart account make it extremely difficult for a thief to access the funds. An ID is required to pick up money in cash.

In sum, Smart Communications has created an innovative product based on the customers' needs, habits and possibilities. The use of state of the art technology has reduced costs and increased the potential reach of the service to even the more remote areas.

Countries like Nepal, Haiti[21] and Mexico have remittance systems that do not pay in money, but pay directly in some kind of predetermined goods. One remittance company for instance allows the senders to pay for a goat to be remitted in Nepal. In Haiti, beneficiaries can choose between different kinds of food, the sender is told how much food can be bought for a specified amount of money. The big advantage of these remittance systems is that they go one step further: They provide the goods the beneficiary would likely have bought for the money remitted. This makes sense if the selection of goods matches what the beneficiary really wants, especially if those goods are hard to get. The drawbacks are that this selection might not always be what it should be. Also, it gives the seller a very strong position in terms of setting excessive prices, as the beneficiary must choose amongst the goods at predetermined prices. If the beneficiary was paid in cash, he could shop around for better goods or prices.

III Prices and Costs

First, we shall discuss the pricing to consumers of remittances, followed by a discussion of the true costs of the remittance companies.

Consumer pricing

The price a consumer has to pay for a remittance depends on a number of market factors:

- The number of competitors in the market, which also depends on the size of that particular remittance corridor and on legal regulations.
- The cost to remittance providers, which depend on the method and technology used.
- Customer needs and preferences, which may include choices available depending on the required speed, the needs at the destination, as well as the sender's legal status.
- Consumers awareness of choices.

[21] http://www.ayitikago.com/food/, Carribean Air Mail Inc http://www.camtransfert.net/caculate/index.jsp

Empirical evidence shows that an increase in the number of competitors generally decreases the price and improves service quality[22].

Some examples of relatively inexpensive remittances fees (excluding foreign exchange costs) are:

<u>United Kingdom to India:</u>

Bank of Baroda, 10 £ for transfers of up to 500 £

ICICI Bank, no fee for account holders, 1-2 £ otherwise

Samachar Remittance, 3 £ for 500 £, 6 £ for 1000 £

Sendwise, flat rate of 3.50 £

<u>United States to India</u>

CashtoIndia, $ 7 for $ 1,000

<u>United States to the Philippines</u>

Philippines National Bank, $ 8 if deposited into PNB account

<u>United States to El Salvador</u>

World Council of Credit Unions, $ 10 for up to $ 1500

<u>Spain to Senegal</u>

Giro Express, 4.50 – 6.00 € per transfer depending on location

<u>Russia to and from Central Europe</u>

Anelik, 1.5 – 3 % fee

[22] Dr Manuel Orozco, Attracting remittances: Market, money and reduced costs, Report commissioned by the Multilateral Investment Fund of the Inter-American Development Bank, January 28, 2002

It needs to be mentioned that there is not a single price for a “commodity called remittance”, just as there is no single price for cars. Remittances are differentiated by a number of characteristics that make them special: Origin and destination, speed of service, security of the transfer and the general customer experience both when sending and receiving the funds.

Nevertheless, the more options a customer is confronted with, the more likely he will be able to find a suitable service at an affordable price.

Apart from very large remittance corridors like the United States to Mexico, the United Kingdom or the United States to India, most remittance corridors have just a few remittance providers, so the market conditions mostly resemble oligopolistic conditions, where the remittance providers charge high prices. This lack of competition in medium and small corridors is sometimes due to limitations caused by regulations, and sometimes due to the relatively small size of the corridor.

The most efficient way of reducing prices in a corridor is to activate competition. The best example is the United States to Mexico corridor, where price have come down significantly in the past 5 years (Orozco)[23].

Cost to providers

One factor influencing the cost to consumers is the cost to the providers of remittance services. In the long run, no provider could subsist at a loss.

The following cost components relating to remittances will be discussed: Staff, technology/ telecom, foreign exchange risk and supply of currency, location costs, administration, anti-money laundering, security and marketing.

All interviewed remittance companies not surprisingly have been tight-lipped about their actual costs. One indication we have received is that staff costs for one remittance company represented 40 % of their total costs, the second component being marketing expenditures.

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[23] Manuel Orozco, Attracting remittances: Market, money and reduced costs, Report commissioned by the Multilateral Investment Fund of the Inter-American Development Bank, January 28, 2002

It should be noted that each provider of remittances might view the incurred costs of remittances in very different ways. Especially if remittances are only a side product offered, staff and IT systems are likely to be considered fixed costs to be incurred anyway if resources are available.

Companies like courier services are able to offer competitive rates for remittance services, as they view it as additional income with little extra costs and a good opportunity to cross-sell products. For safety reasons, most courier companies will not accept cash to be transported.

Banks also offer remittances as a side product, either to attract ethnic customers, or because they feel that a bank needs to offer a full range of financial services to an ever more demanding customer base. Nevertheless, banks have much higher costs than other categories of remittance companies. Better paid staff with better benefits, security and often a much more representative building in a better neighborhood, add significantly to costs. Because remittance services are viewed as one product of the portfolio, they get allotted a share of the overhead costs. For that reason, many large banks have offered few remittance products, as they see them as much less profitable as large loans. The only category of banks that are very likely to offer remittance services as a significant product of their portfolio are regional banks with headquarters in a developing country (Indian, Moroccan banks for example).

<u>Staff costs</u> are much higher in developed nations than in developing countries. Most of the staff involved in remittance is counter staff, probably not costing more than $ 15 per hour. Other staff involved is back-office handling, accounting, compliance, operations and the like. For efficiently handled remittance systems, the total manpower time necessary to perform a remittance should not exceed 10 minutes per transfer, so a <u>maximum</u> staff cost of $ 2.50 per transfer is probably fair.

The actual staff cost could be significantly lower in the case of automated systems that require almost no direct staff intervention. One example would be remittances systems based on accounts and debit cards, where the sender deposits money onto the debit card of the receiver, who then is able to collect it either at ATMs or spend it in shop, using the card as a means of payment. Actual costs for this kind of transfer are likely to be in the range of a few cents.

Marketing costs vary widely between the different remittance companies. Large companies like Western Union and MoneyGram spend significant amounts on nationwide marketing campaigns to be at the forefront of people's mind. Smaller niche players do not have these resources, and often not the same need, as they rely much more on a neighborhood word of mouth. Also, a cheaper service is less likely to have the necessary resources. Banks rarely spend significant amount on remittance advertising, as they often see remittance as one product of an entire portfolio.

The actual technology costs (transfer software, if any, and telecom costs) have certainly decreased over the past years. Depending on the volumes of transfers and the technology used, these costs can represent less than 1 cent or up to an estimated maximum of 1 dollar.

There are costs involved with the supply of cash, as well as foreign exchange risks. Although some remittances are paid in the same currency as they were originally sent in, most remittances are paid in the local currency at destination, which makes a conversion necessary. Remittance companies convert the original amount sent into that local currency at a rate that gives them a profit, which is covering the risks involved with the fluctuation of currencies and the cost of providing cash at destination.

This difference in the conversion rates (spread) is often in the range of 1 – 3 % of the amount sent. It must be noted that the risk the remittance company is carrying is limited to the net amount due, as these companies often also perform remittances in the opposite direction, which reduces the total exposure risk. While the remittance fees are openly advertised and known to the public, knowledge about the foreign exchange costs associated with the transfers is thought to vary widely.

Location costs are all costs necessary for the maintenance of the locations, where remittances are offered. Locations dedicated solely to remittances are very rare. Companies focusing solely on remittances mostly rely on agent locations, where the agents run other major line of business, from supermarkets to pharmacies. Banks really do the same, by offering a wide variety of financial products next to remittances. The necessary volumes of remittances to cover location costs entirely are relatively high. Essentially, location costs can be considered as fixed, so higher volumes imply lower unit costs.

Security costs can be significant, especially for cash-based remittance systems. In developing countries, the majority of remittance receivers are unbanked, so they generally have to receive their funds in cash.

Systems not requiring locations, like account-based systems or on-line systems are generally generating less costs and tend to be cheaper priced as well.

Administrative costs including costs for anti-money laundering are typically covered as part of overhead costs. Several interviewed remittance companies have mentioned increased costs due to anti-money laundering measures taken since Sept 11, 2001.

It needs to be pointed out that there are significant economies of scale for remittance services, as many of the costs seem to be relatively fixed.

An efficient, large-scale remittance system could be operated with the following costs, excluding marketing costs, which are not technically necessary to offer the service.

	First transaction	**Subsequent transaction**	**Electronic processing**	**Comment**
Sending staff costs	$ 2.50	$ 0.83	$ 0.50	$ 15 per hour
Receiving staff	$ 0.17	$ 0.17	$ 0.17	$ 1 per hour
Fixed costs	$ 0.27	$ 0.27	$ 0.27	$ 40 million system cost over 10 years. 2000 branches with 20 transactions/day
Variable non-labor costs				
IT, telecommunication	$ 0.60	$ 0.60	$ 0.60	
Rent	$ 1.50	$ 1.50	$ 1.50	$ 30 rent per day, 20 transactions, lower of side business
Administrative Overhead	$ 0.50	$ 0.50	$ 0.50	Compliance, general overhead
Total costs	**$ 5.54**	**$ 3.60**	**$ 2.94**	

IV Recommendations

The above discussion has identified remittance companies as opposed to banks as the main players in remittances, except where the legal restrictions mandate otherwise. In some countries remittances are treated as a regular banking service, while it as a separate status in others. The review of the legal framework has yielded that the applicable regulations vary widely without obvious reasons, which is an added burden to remittance providers. The costs incurred by remittance companies depend on the business model including networks, service attributes and technology used. The pricing to consumers appears to be dependent upon the level of competition in the specific remittance corridor. The above findings are the basis for the following recommendations:

Recommendation 1: Recognize remittance as a self-standing industry different from banking and thus broaden the number of players in most corridors

The remittance industry is a different industry from banking. This is recognized in a number of countries like the United States, Canada, the United Kingdom and Sweden, but not in other countries like Germany or France.

It should be noted that Austria, as of January 1st, 2004 has changed its legislation regarding money transfer services: the capital requirement is 36,000 Euro for a limited company and 72,000 Euro for an incorporated entity. Just one managing director is needed instead of two previously and a concession may be obtained even if your main activity lies somewhere else. However, these new entities are subject to the very same anti-money laundering rules that banks are subject to.

Certainly there are similarities, as both industries deal with money in one form or another, but the differences are significant:

- Banks target audiences are usually high net worth citizens, whereas remittances are sent by low net worth immigrants.
- Most banks offer most of their business locally (checks, loans, mortgages), while remittances are mostly international.

- Banks tend to make money on deposits or the float of transfers, i.e. by holding the money, while remittance companies make money on the fast payment to the beneficiary.
- Banks go for long term, high value financial services, remittances are low value and often one-time activities.
- Banks offer a variety of more or less complex products, remittances are a single and relatively simple product.

By not making available a remittance license separate from a full banking license, market conditions are severely impacted. It is probably easier to take an example from another industry: transportation. Assume that in country A, there are three types of driver's licenses: private cars, taxis and trucks. In country B, there are only two kinds of driver's licenses: private drivers and professional drivers, whereas an intermediate category suitable specifically for taxi services is missing. In both countries, you have the same demand for transporting people in taxis and merchandise in trucks. In country B, a taxi driver being a professional driver would thus need the same license as a truck driver. If the taxi driver cannot obtain that license for whatever reason (qualifications, expense), he will very likely have to drive his car informally, as the expense of getting the license is too high. Even if he could afford a truck license, it would make much more economic sense to use the license fully and thus drive a truck. Operating an official taxi service would also be unreasonable for another reason: as no specific licenses are available, those taxi drivers not able to obtain a license will drive taxis unlicensed and will thus offer a cheaper service. In country A, the taxi and truck businesses each go after what they do best.

Please note that even if the conditions for obtaining a license should be differentiated, this does not imply that there should be differences regarding reporting, anti-money laundering and customer identification. In fact, these rules should be identical for banks and remittance companies, if the service rendered is the same. This is discussed in more detail in recommendation 2.

Allowing other companies than banks to offer remittance services would have the following positive impacts:

More players generally increase competition, which generally reduces prices.

The distribution networks for remittances would increase and thus facilitate both sending and receiving remittances.

In the sending countries, remittance services could be offered by people of the same origin, thus speaking the language, being familiar with name spelling, geography and making their customers feel more comfortable and often living in the same neighborhoods.

In the receiving countries, a dense network is even more important than in developed countries as means of transportation are often scarcer. Shops, pharmacies and even gas stations in remote areas could be suitable payout locations, if nothing else is available. The frequent issue of cash availability for payouts could be overcome, if shops are selected that receive large cash payments for the goods they sell. In this case, offering remittance payout also has the added benefit of reducing the total amount of cash in hands, which often is a security issue in remote areas.

Recommendation 2: Harmonize regulations governing remittances…

…within a country.

The table on page 7 illustrates the extreme differences between States within the USA. Many of the remittance companies interviewed have clearly mentioned that these differences make little sense and only distort competition, while adding unnecessary costs.

Within a country, collateral and other licensing requirements as well as operational requirements like reporting should be identical. Like the United States, Germany is also a federal state. The German regulations on financial services are federal regulations valid identically in any German state.

Ideally, conditions for remittance companies should be identical in all countries. This is not realistic, as economic conditions and legal traditions vary greatly from country to country. However, it would be achievable to set the requirements for remittances depending on the associated risks, the volumes transferred and the like.

…for all remittance providers alike

Currently, the regulations in terms of licensing, anti-money laundering, ID requirements and reporting are different for banks and remittance companies offering exactly the same service in the United States. Money transmitters are regulated under the Money Transmitter Act, while banks operate under the Banking Act.[24]

Several companies interviewed have indicated these differences in regulations for the same service as a significant source of confusion, especially in the case where a bank is paying out a remittance as an agent of a remittance provider.

…for all senders and receivers

The current regulations sometimes discriminate between senders, when some remittance systems require the sender to have a legal residency permit. This is often the case of banks, which make a bank account a prerequisite for sending money. A bank account in return requires a social security number and other documents only a legal resident may obtain.

It may be argued that if somebody does not have legal residence, he or she cannot have a legal income and thus may not send money.

The key question in terms of anti-money laundering is whether the funds have been obtained in a criminal manner, and most illegal immigrants do have honest jobs that are not criminal in any manner (except maybe tax evasion).

Technically, the regulations require identifying the sender and the beneficial owner of the transfer, which says nothing about that person's legal status. A foreign passport or other acceptable forms of identification are certainly acceptable for performing remittances, and the legal status should not be an issue.

If the legal status requirement persists, the undocumented sender will have to choose informal ways of transmitting, which leave even less of a trace. So it is clearly in the interest of government to allow specific foreign IDs.

[24] Ideally, anti-money laundering rules should be identical in and for all countries. Especially for anti-money laundering reasons, some states and some countries pay special attention to transfers, including remittances, going to or originating from some countries, like Cuba, Afghanistan, Myanmar etc.

This list is not consistent between the states and countries, which both adds a burden on remittance companies being confronted with complex regulations and also undermines the overall effectiveness of these measures. Individuals wanting to remit money say from the United States to Cuba can simply do so by sending it to the United Kingdom, where it is forwarded to its destination in Cuba.

The Fed has issued directives on how to handle remittances originating from undocumented workers.[25] Essentially the directive says that the person needs a proof of identity, which can also be a passport or an equivalent document. The U.S. Code of Federal Regulations, Title 31, Volume 1, Section 103.28 on page 340 describes the identification requirements as follows:

> Before concluding any transaction with respect to which a report is required under Sec. 103.22, a financial institution shall verify and record the name and address of the individual presenting a transaction, as well as record the identity, account number, and the social security or taxpayer identification number, if any, of any person or entity on whose behalf such transaction is to be effected. Verification of the identity of an individual who indicates that he or she is an alien or is not a resident of the United States must be made by passport, alien identification card, or other official document evidencing nationality or residence (e.g., a Provincial driver's license with indication of home address). Verification of identity in any other case shall be made by examination of a document, other than a bank signature card, that is normally acceptable within the banking community as a means of identification when cashing checks for non-depositors (e.g., a driver license or credit card).

Recommendation 3: Improve remittance channels

Some countries give access to the automated clearing houses (ACH) only to full banks. This technology would be very helpful and inexpensive also for credit unions, which potentially would be much more interested in offering remittance services, but now are excluded from them.

Another possibility of improving the remittance channels would be to include the post offices in these ACH networks. In most countries, post offices have an extensive network covering even remote areas. Also, poor customers might feel a lot more at ease in a post office than in a commercial bank.

[25] The World Council of Credit Unions has issued a very useful guide on how to serve undocumented individuals. See https://www.woccu.org/pdf/Undocumented_Individuals.pdf

The World Bank could also facilitate remittances generally by providing loans for projects supporting the development and installation of technologies used for the payment of remittances in developing countries. Quite often, the level of technical equipment in rural areas is very basic, which limits the possibilities of paying remittances in these areas.

Recommendation 4: Improve customer awareness

Consumers are only likely to use a specific remittance if they are aware of it. It can be assumed that the consumer will choose between the available whichever option is best, taking into account the price and the service provided.

While the consumer generally is informed of the transfer fee, the awareness of the cost of the foreign exchange is unknown. Some service indicate that cost very clearly while others do not. At the best, some consumers inform themselves of that cost, while most others are unaware of it.

Mexico is an excellent example of a remittance corridor where prices have decreased significantly over the years. A key reason for this is certainly the large number of players, but customer awareness regarding services and prices is certainly very relevant as well. The Mexican government has institutionalized the collection and distribution of remittance information (services and costs from a series of cities in the United States) both by Condusef [26] and Profeco[27], which are consumer organizations. This kind of initiative would be very beneficial as well for other destinations and sender countries.[28]

The findings of this paper should be treated as preliminary, subject to a more detailed examination of the regulations governing the remittance business and their impact. Until now, remittances in particular and retail payments in general, have not received the same degree of attention from policy makers as large-value transfers which form the bulk of international payments. One reason for this apparent lack of attention is lack of adequate data (and even definition). Collecting corridor-specific data would go a long way towards

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[26] http://www.condusef.gob.mx/transferencias_eu_mex/encarte_remesas.htm

[27] http://www.profeco.gob.mx/html/envio/costoyc.htm

[28] The World Bank together with the Bank for International Settlements Committee on Payment and Settlement Systems has formed a task force to develop voluntary standards for improving transparency in remittance transactions.

informing policy as well as generating competition. Such efforts should aim to collect information on flows, costs, and also on incidence of abuse by all parties, customers, remittance service providers, and regulators as well.