

WORKER REMITTANCES AS A DEVELOPMENT TOOL

OPPORTUNITY FOR THE PHILIPPINES

**Kevin Mellyn
Consultant
Manila, Philippines
13 June 2003**

The views expressed in this paper are those of the author(s)
and do not necessarily reflect the views or policies of the
Asian Development Bank.

Copyright: Asian Development Bank 2003

All rights reserved.

The views expressed in this report are those of the author and do not necessarily reflect the views and policies of the Asian development Bank, or its Board of Governors or the governments they represent.

The Asian Development Bank does not guarantee the accuracy of the data included in this report and accepts no responsibility for any consequences of their use.

Use of the term “country” does not imply any judgment by the author or the Asian Development Bank as to the legal or other status of any territorial entity.

CONTENTS

	Page
I. EMERGENCE OF REMITTANCES AS A DEVELOPMENT TOOL	1
A. Global Picture	1
B. Latin American Experience	1
C. Relevance to Asia	3
II. OVERVIEW OF REMITTANCE MARKET IN THE PHILIPPINES	4
A. Market Definition	4
B. Market Size Estimates	5
C. Market Segmentation	6
D. Formal and Informal Channels	8
E. Competition and Prices	8
F. Payments System Issues	9
G. Legal and Regulatory Aspects	9
III. EFFICIENCY ISSUES AND CONSTRAINTS IN SENDING COUNTRIES: “FIRST MILE PROBLEM”	10
A. Access to Banking in Sending Countries	10
B. Retail Payments Services and Sources in Sending Countries	10
C. Limitations to Market Access by Philippine Banks	10
D. Correspondents and “Tie-ups”	10
E. Role of Money Transfer Businesses	11
F. Legal and Regulatory Issues	11
IV. EFFICIENCY ISSUES AND CONSTRAINTS IN THE PHILIPPINES: “LAST MILE PROBLEM”	11
A. Unbanked Population Constraints	11
B. Bank Network Constraints	12
C. Payment System Capillarity Constraints	12
D. Rural, Thrift, and Microfinance Segments	12
E. Role of Couriers and Logistics Firms	13
F. Financial Literacy and Behavioral Constraints	13
G. Legal and Regulatory Aspects	13
V. INTERNATIONAL PAYMENT SYSTEMS	13
A. Deposit Money System	13
B. Payment Card System	13
C. Postal System	14
D. Emerging Technologies	14
VI. OPPORTUNITIES FOR THE PHILIPPINES	14
A. Increase Net Remittance Inflows to Formal Sector	14

B.	“Bank the Unbanked”	15
C.	Increase Investable Resources in the Philippine Financial System	15
D.	Leverage Remittances for SME Development and Microfinance	15
E.	Accelerate Use of Non-Cash Payment	16
F.	Enhance Revenue Sources of Formal Depository Sector	16
G.	Protect Consumers from Fraud and Excess Charges, Promote Formal Channels	16
VII.	RECOMMENDED COURSES OF ACTION MULTILATERAL INSTITUTIONS	16
A.	Develop Optimization Program for Remittances	16
B.	Key Processes and Outputs	16
C.	Philippines as Template	17
APPENDIXES		
1.	Issues Map	18
2.	Key Measures	19
3.	Segmentation Scheme Illustration	20
4.	Transaction Flow Map	21

I. EMERGENCE OF REMITTANCES AS A DEVELOPMENT TOOL

A. Global Picture

1. Remittances by individuals working abroad to their home country is a very old phenomenon. After the Great Famine of 1846–1848, an Irish Diaspora spread across the British Empire and the Americas. Remittances, especially from female domestics in the US, became the single most important source of capital for the Irish countryside. Remittances from the US to Italy were of vital importance when foreign credit was cut off in 1907. From 1950–1960, remittances were the key to the development of Greece, Portugal, Spain, and Yugoslavia.

2. The modern appreciation of remittances as a development tool is very recent and represents an irony of globalization. The first great age of globalization (from 1815–1914) involved Britain exporting 4–5% per annum of national income and nearly 20 million people, mainly from the poor “Celtic Fringe” (Ireland, Scotland, and Wales) to developing countries, above all the United States (US). Today, the US is a large net importer of capital and people from developing countries and reciprocal capital flows to developing countries are, to an ever greater extent, the product of either permanent or temporary migration of individuals seeking economic opportunities in higher income countries, especially the US.

3. The Global Development Finance 2003 Annual Report took formal notice of this for the first time¹.

4. The report takes a very conservative calculation of remittances based on official IMF balance of payments data. Even so, global remittances by individuals were estimated at over \$100 billion for 2001, with \$72.3 billion going to developing countries. The report notes that this is (i) more than capital market flows, (ii) more than official aid flows, and (iii) more than half of foreign direct investment flows. Moreover, remittances are more stable than any of these sources and tend to be counter cyclical, thus serving as a buffer from external economic shocks.

5. Remittance receiving countries are concentrated in three regions: East Asia, Latin America, and South Asia. In turn, each region has a dominant country. Mexico alone, at \$9.9 billion, accounts for 34% of Latin America, while India at \$10 billion accounts for 73% of South Asia. The Philippines, at \$7 billion, accounts for 43% of East Asia.

6. Remittance sending countries are also very concentrated. The US alone was the source of nearly \$30 billion of remittances in 2001, while Saudi Arabia was the source of \$15 billion (combined Saudi Arabia and Gulf states around \$20 billion). The European Union (EU) figures include intra-European remittances, but in aggregate represent the third largest source of remittances to the developing world.

B. Latin American Experience

7. Latin American migration to the United States has created a “Hispanic” community of over 35 million over the last two decades. In 2002, the region received remittances totaling \$32 billion, a 17.6% increase over the year before. Some 78% of remittances came from the US

¹ Dilip Ratha. Worker’s Remittances. *An Important and Stable Source of External Development Finance*. Chapter 7.

alone, though the Brazilians resident in Japan and Latin Americans in Spain are other major sources.

8. Among receiving countries, Mexico received \$10.5 billion, about a third of the total, with Central America, the Caribbean countries, and the Andean region each receiving about \$5.5 billion. In six countries, remittances represented over 10% of gross domestic product, reaching over 29% in the case of Nicaragua. The Multilateral Investment Fund (MIF) of the Inter-American Development Bank (IADB) estimates that at a very conservative growth rate of 7% a year, Latin America and the Caribbean will receive over \$400 billion in remittances in this decade.

9. The intensity of remittances flows to Latin America has caused the MIF to make a focused effort to analyze and track the end-to-end process of sending money home to Latin America with a view to improving transaction efficiency and costs, and leveraging these flows as a development tool.

10. The public manifestation of this effort began in May 2001 with a regional conference in Washington on "Remittances as a Development Tool." This showcased some of the early MIF research, which showed that over \$15 billion flowed from the US to Latin America in 2000, a fact which received broad attention in the US financial press. This fact and a program of outreach to US financial institutions caused large US banks such as Bank of America, Citibank, and Wells Fargo, to focus on Hispanic remittance markets, especially between the US and Mexico, for the first time.

11. As the World Bank's Global Development Finance Report noted, two major foreign direct investment (FDI) transactions for Mexico, the \$12.5 billion Citibank-Banamax deal (the largest ever for that market) and Bank of America's purchase of a \$1.6 billion in Banco Serfin, are both associated with the large and fast-growing business opportunities associated with the workers' remittances highlighted in the MIF's research.

12. The headline issue for the MIF and general manager Don Terry has been the outrageous costs of sending money home to Latin America. These are estimated at \$4 billion for 2002 alone, the highest of any region in the world.

13. IADB has been attacking these costs through stimulating competition through research, and a dialog with the banking sector, including credit unions and bank payments card companies (Visa, etc.). The US-Mexican Partnership for Prosperity has also helped develop programs to increase access to banking services, especially for the large number of illegal Mexican workers in the US. These efforts in conjunction with class-action lawsuits in California and other states have forced the quasi-monopoly providers of money transfer services, Western Union and Money Gram, to radically reduce prices for Mexico and some Central American markets over the last few years.

14. Average costs, fees plus foreign exchange spread, of sending \$200 to Latin America fell to \$20 in 2002, about half of what it was in 1999, and there is anecdotal evidence that Western Union has reduced fees to as low as \$3 in some markets to retain market share and foreign exchange spread income.

15. The MIF goal is to reduce remittance costs to an average of 5% over 5 years. At 5%, the net remittance flows into Latin America would have been \$2.4 billion higher in 2002.

16. The cost aspect of IADB remittance effort should not be overemphasized. A detailed look at MIF activities in remittances reveals that the fund is actually executing a “cluster strategy” that combines three mutually reinforcing elements (i) improving cost and service by stimulating competition and innovation in the private sector; (ii) improving access to financial services for both Hispanic workers in developed countries and the poor in receiving countries; and (iii) building effective linkages between remittance flows, savings, and investment, SME funding, and microfinance.

17. Specific programs have been developed to (i) strengthen financial infrastructure in receiving countries, (ii) link remittances to SME development and microfinance, (iii) develop private sector competition in sending markets, and (iv) increase access to banking services in sending countries.

18. The MIF has approved \$12 million of financing for projects totaling over \$25 million in Brazil, Dominican Republic, Ecuador, El Salvador, and Mexico since 2001.

19. These include (i) \$1.5 million to improve financial services and remittances in El Salvador by helping FEDECACES (the federation of credit unions serving the poor) develop automated transaction and management information systems, better training and governance, and new financial products tailored to families receiving remittances; and (ii) \$3.5 million to strengthen Mexico’s popular savings and loan sector, specifically the 1,000 branch network associated with Banco del Ahorro Nacional y Servicios Financieros (BANSEFI). Funds will be used to help these institutions to introduce new financial services to small and medium sized enterprises, and upgrade their technology platform to help them compete in the market for remittances.

20. Besides the US banks entry into the remittance market (50 institutions to date offering dual-ATM products alone), the MIF has developed an alliance with the Spanish savings bank system (La Caixa). Latin American and Caribbean savings, and microfinance institutions will receive assistance from La Caixa to make remittance distribution more efficient using payment card technology and reach low-income groups with tailored financial products and services. Money can now be sent from Spain to Ecuador for as little as \$3. Western Union has slashed its prices to that level to compete.

21. MIF has also contributed to programs to spread financial literacy and access to banking in the US working with both US Authorities and the Government of Mexico. The most notable success has been the addition of about one million illegal Mexican workers to the US banking system by the growing acceptance by U.S. banks of a Mexican government consular document called a matricula (a photo ID attesting to valid Mexican citizenships), and US taxpayer ID number as adequate documentation to open a bank account.

C. Relevance to Asia

22. In combination, increased competition, broadened access to banking, outreach to local communities, and strengthening grass roots banking have had large impacts for modest resources on the part of the MIF.

23. Asia represents a remittance market of comparable size to Latin America, though a far more complicated one insofar as the major labor exporting countries (e.g., India, Pakistan, and the Philippines) are far more diverse and their overseas communities are more segmented by occupation, education, and country of residence. Furthermore, unlike Latin American and

Caribbean emigration, which is overwhelming to Canada, the EU and the US, there is significant intra-regional migration in Asia. There is also a large formal contract labor market in the Middle East, and to a smaller degree, Hong Kong, Japan, and Singapore.

24. That much said, however, there are key similarities. In both cases, remittances represent a significant inflow of income for poor families, and especially women and children. Costs appear on an average lower, but nonetheless represent a significant “tax” on a scarce resource. Above all, remittances have not been effectively leveraged as a development and poverty alleviation tool.

25. Finally, one overarching issue connects the two markets, the persistence of alternative remittance systems (ARS) in remittances worldwide. These are the traditional means of transferring money that pre-date and continue to run parallel to the formal banking system worldwide. They account for up to 50% of all remittances by some estimates.

26. The US Treasury, World Bank, regional international financial institutions (IFIs), and national governments have all focused on the linkage between ARS and terrorist financing and money laundering issues and increasing financial integrity generally. The consensus strategy for counter terrorist financing (CTF) and anti-money laundering (AML) is not to drive alternative remittances underground, but to regulate them to formal sector standards as much as possible and to channel a much higher percentage of remittances to the formal sector.

27. Since remittances held as deposit money in the banking system and its microfinance extensions has an estimated multiplier effect of between two and three, according to MIF research, shifting remittances to formal channels has clear development advantages, even if volumes and costs remained static. Therefore, shifting remittances to the formal sector serves two important purposes at once.

28. The most effective means of shifting remittances to formal banking channels is to make them more accessible, cost effective, timely, and safe for senders and receivers.

29. Thus, although the APEC Alternative Remittance Systems (ARS) initiative and related global efforts to promote financial integrity are not the primary focus of this report, the research and action programs to promote remittances as a development tool in Asia may be useful to financial integrity efforts in the region.

II. OVERVIEW OF REMITTANCE MARKET IN THE PHILIPPINES

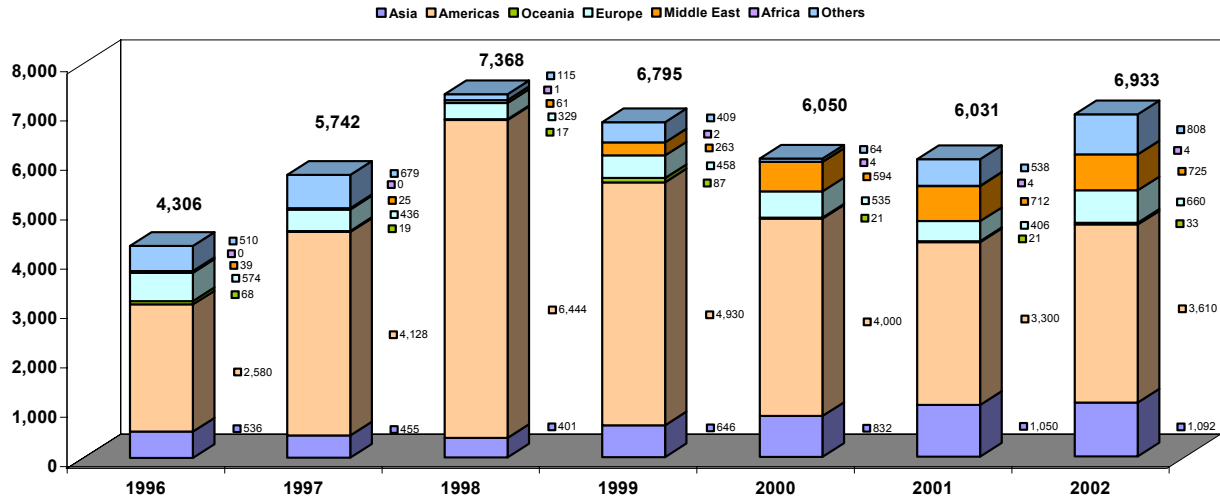
A. Market Definition

30. For the purposes of this report, the remittance market represents the total funds sent by individuals resident abroad to recipients in the Philippines through both formal (i.e., banking system) and informal (i.e., “ARS”) channels. Therefore, our focus is much broader than the remittances of overseas Filipino workers (OFWs). At the same time, we are looking at what in payments system terminology is called “person-to-person” payments, so we have not for example looked at US social security or military pensions to Philippine residents.

B. Market Size Estimates

31. Official Bangko Sentral ng Pilipinas (BSP) data (see Figure 1) indicates a remittance flow of about \$6.9 billion in 2002, fully \$3.6 billion of which came from the US and Canada. These numbers are mere compilation of returns from the commercial banks of their remittance activity.

Figure 1: Overseas Filipino Workers' Remittances (\$'000)
By Region



Data are not truly reflective of the actual country deployment of OFW's due to the common practice of remittance centers in various cities abroad to course remittances through correspondent banks mostly located in the U.S. Since banks attribute the origin of funds to the most immediate source, U.S., therefore appears to the main source of OFW remittances.

Source: Bangko Sentral ng Pilipinas

32. The data is misleading on two accounts.

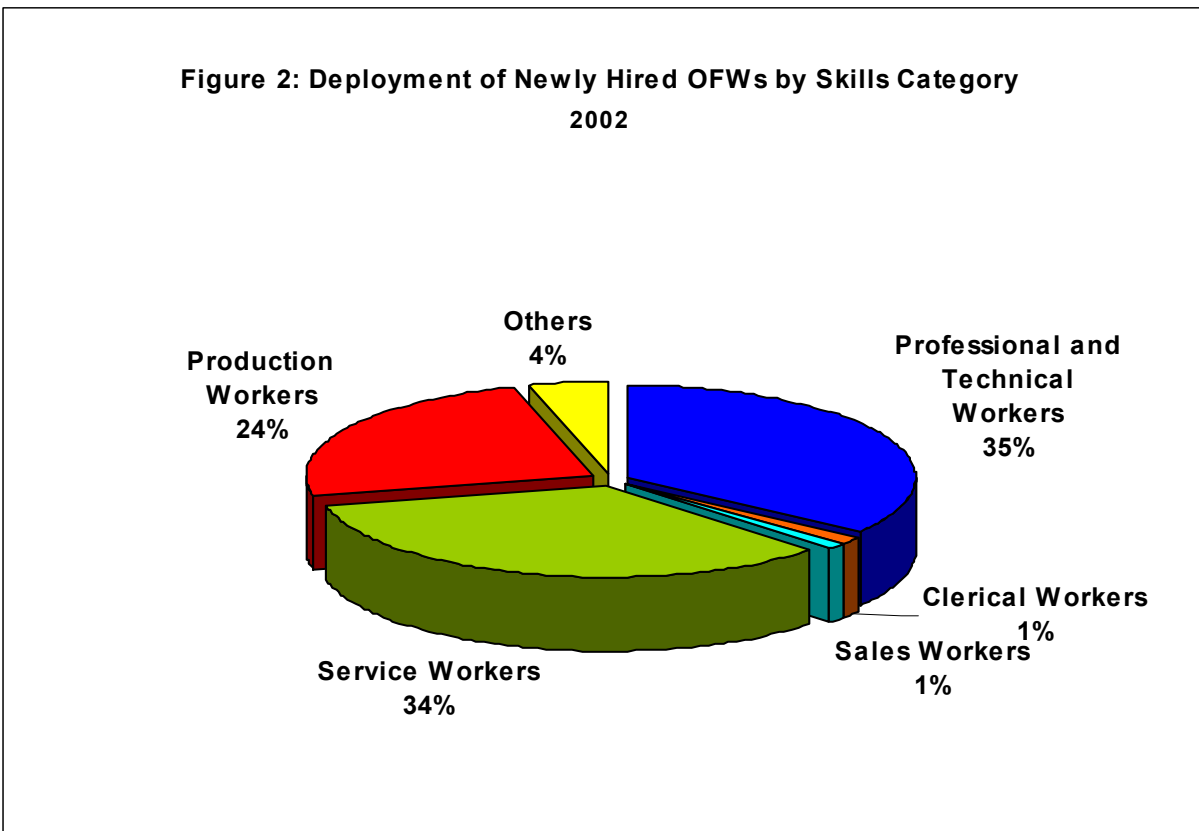
- (i) The stock of overseas resident Filipinos, including emigrants, OFWs, and illegal aliens, is in the range of 7.5 million. Even an average remittance of \$100 ten times a year would exceed the official numbers. Since data from the National Money Transfer Association in the US indicates the average value of a single remittance to the Philippines is \$397, it is reasonable to assume a conservative average remittance of \$200 ten times a year or even an average of \$300 per remittance (on par with Mexico, a much lower paid group than Filipinos on average). These estimates would establish a range of \$14 billion to \$21 billion for total market size.
- (ii) Virtually all US dollar remittances flow through the US banking system because both Philippine banks and Saudi Arabian and other Gulf State banks hold their principal US dollar nostro accounts in New York. The size of the OFW deployment in the Middle East and its average earnings suggest that the US and Middle East, each account for about one-third of remittances.

C. Market Segmentation

33. In contrast to the Latin American situation, where the remitting community abroad consists overwhelmingly of poorly educated unskilled workers in low wage jobs in the US and Europe, the Philippine diaspora is demographically and geographically complex.

34. Philippine educational standards are high relative to Mexico and Central America. There is a formal OFW program to assist Filipinos seeking work abroad, which looks after OFW welfare and that of their dependents at home. These factors are almost totally absent in Latin America.

35. As a result, Filipinos working abroad have a wide range of skills and include a high percentage (35%) of professional and technical workers on one end of the spectrum and a correspondingly large segment of service workers, including mainly female domestics on the other (see Figure 2). Philippine ship manning agencies have also created a large “sea-based” segment ranging from stewards to skilled seamen and officers. Large numbers of Filipinos serve in the US armed forces. This results in a very wide range of income and remittance potential, as well as mobility to travel to and from the Philippines (and with it the potential for a high percentage of hand carried remittances).

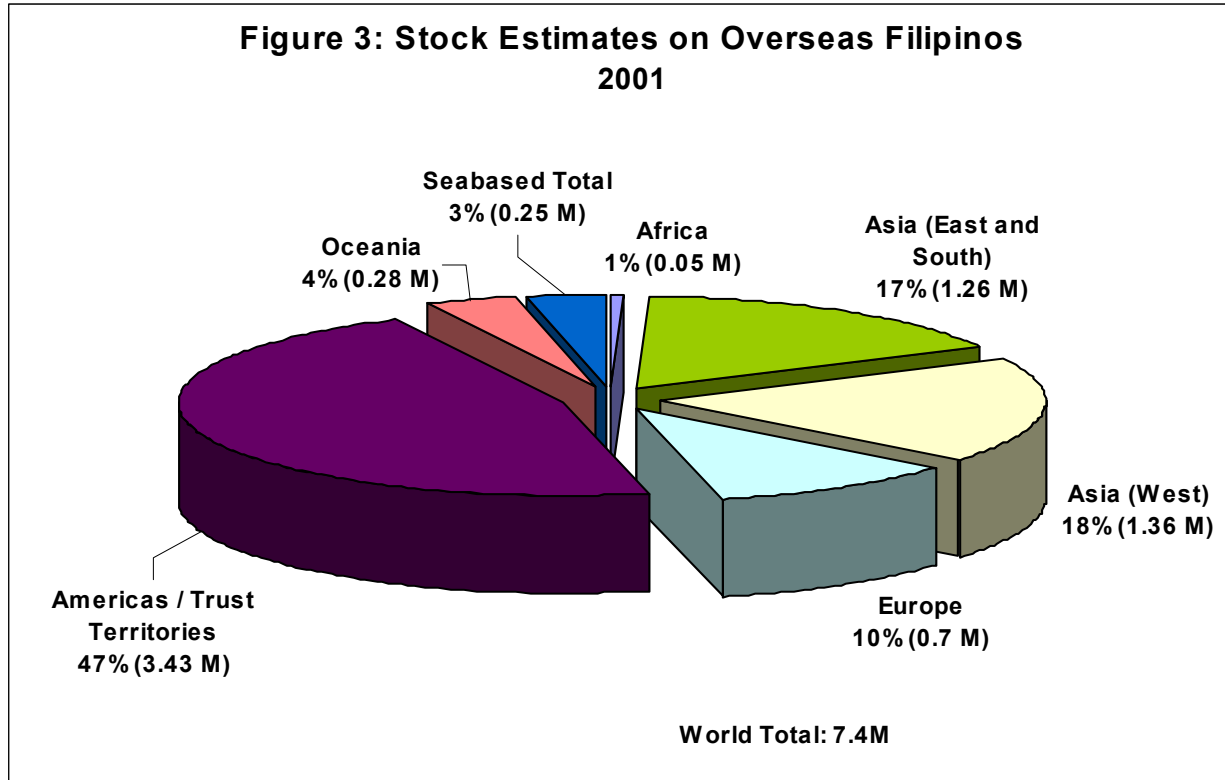


Source: Philippine Overseas Employment Authority

36. This means that any valid study of remittance behavior must be segment specific, at a minimum distinguishing between (i) professionals/paraprofessionals; (ii) technical and clerical

workers; (iii) skilled production workers; (iv) industrial, construction, and agricultural laborers; (v) service workers and domestics; and (vi) mariners.

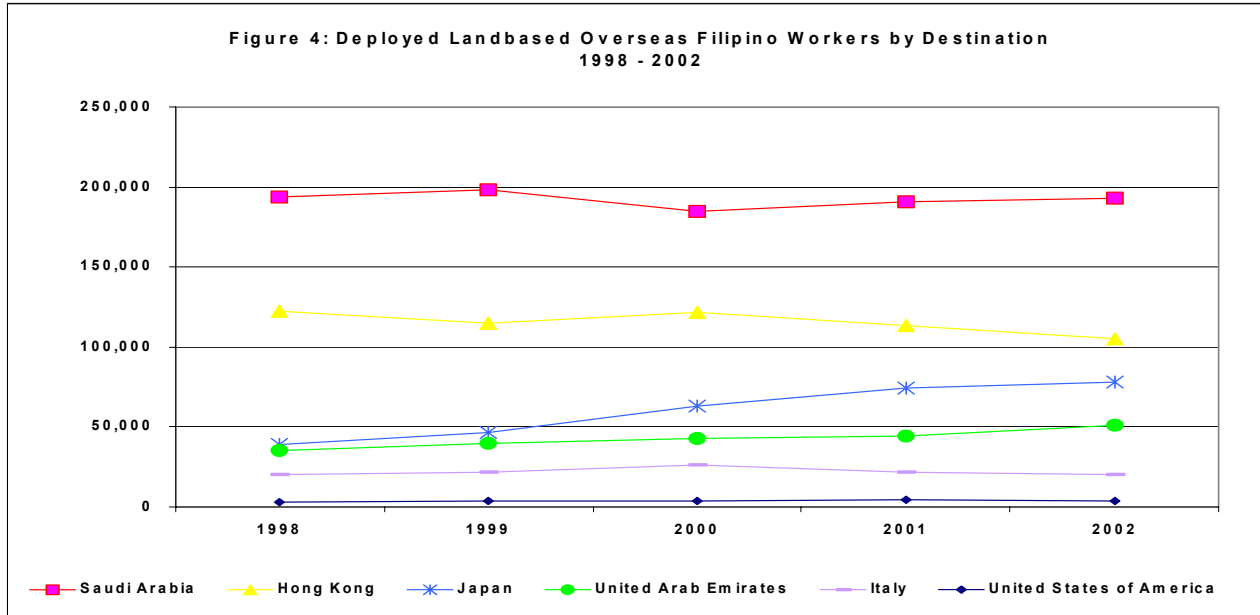
37. The Philippine diaspora covers 140 or so countries. Filipinos are present in significant numbers in North America, Europe, the Middle East, and both high income and developing Asian countries.



Source: Commission on Filipino Overseas, Department of Foreign Affairs.
Asia (West) includes Saudi Arabia and Middle East countries.

38. Stock estimates of Filipinos overseas (see Figure 3) show the largest group (3.4 million or 47%) to be in the US or its trust territories in the Pacific. However, the vast majority of Filipinos in the US are permanent residents, about 2 million legal and 1.2 million of irregular status. As a group, they are less likely to be supporting dependents in the Philippines than OFWs. OFWs, on the other hand, largely work abroad on renewable contracts for fixed periods precisely to support their families or accumulate capital, especially in the form of housing. Many of them deploy to countries like Saudi Arabia and the United Arab Emirates (UAE) where permanent emigration is scarcely an option for most Filipinos (see Figure 4).

39. This suggests that segmentation needs to be overlaid with geographical distribution to generate valid insights into remittances behavior.



Source: Philippine Overseas Employment Authority

D. Formal and Informal Channels

40. Formal banking channels account for a far larger share of Filipino remittances than in the case of Latin America, largely due to the long-standing involvement of the Philippine National Bank (PNB) and more recent market entry by other commercial banks. At worst case, they account for a third of the real potential market and may account for half.

41. However, reducing the informal share of remittances has tremendous financial leverage simply because of the scale of the flows. The presence of thousands of money changers and large scale mall chain involvement in changing foreign currency into pesos suggest that a very large flow of remittances come into the country as cash in US dollars or Japanese yen. It seems likely that much of this cash is brought or sent home through informal channels, though accurate estimations are not available.

E. Competition and Prices

42. The formal (bank channel) Philippine remittance market is highly competitive and reasonably priced by Latin American standards, but there is substantial scope for improvement. Philippine bank charges range from around \$5 (book transfer within one bank, foreign account to local branch account) to \$16 on the high end, which can include door-to-door courier delivery. Manuel Orozco of Inter-American Dialog has done studies for the MIF suggesting total end-to-end charges to send \$200 from the US through a Philippine bank average around 8%.

43. Interestingly, the PNB believes the service is underpriced relative to their costs and have added \$1 to the average transactions. The market has followed suit. This is not unreasonable given the brick and mortar costs these Philippine banks bear, and their need in many cases to employ couriers. They have limited ability to lower end-to-end costs since their front-end tie-ups set their own prices for remitters.

44. The bank remittance market, with 90% of bank transactions in six major institutions (30% in PNB alone), is expanding as an important source of fee revenue for the commercial banking sector. The recently formed Association of Bank Remittance Officers is a useful forum for addressing common industry issues such as overseas market access and serves as a single point of contact on remittance issues.

45. The sheer size of the market continues to attract new entrants including banks (Union Bank, Planters Development Bank, Standard Chartered); card companies (Visa); the Postal Savings Bank in association with its parent, the Philippine Postal Services; the Rural Bankers Association; and various entrepreneurs and nongovernment organizations (NGOs), (Opportunity International in association with Mastercard). Many of these initiatives are still in the planning stage or are seeking funding.

46. Despite the above competitive situation, non-banks and informal channels remain robust and anecdotal evidence suggests that they may be expanding their share of the market.

47. For example, Western Union, in five years, has captured a market share estimated as high as 20% of wire transfers using nearly 7,000 outlets as of year end 2002 with thousands more in the pipeline (including bank branches where banks use them as an overseas “tie-up” or front-end). Last year, Western Union enjoyed a 73% compound annual growth rate in remittances to the Philippines, despite prices above \$20 in most US markets. Overall, Western Union looks to growth in Asia as critical to achieving their corporate goals.

48. LBC and other small courier and logistics companies transport packets of cash back to the Philippines from markets like Hong Kong, Singapore, and the Gulf, where there are large concentrations of OFWs. These services are cheap (as little as \$3) and considered acceptably reliable by remitters.

F. Payments System Issues

49. The Philippine payments system has largely developed through the efforts of local and international (notably Citibank) banks and payment companies. Aside from the BSP’s Real Time Gross Settlement interbank system (RTGS), which by definition is a central bank responsibility, the authorities have viewed payment systems as a matter for the private sector. The Philippine Clearing House Corporation (PCHC) is owned by a consortium of member banks. It facilitates interbank check clearings, and has developed a low cost electronic giro or ACH mechanism that can pass peso or dollar interbank payments for a tariff of 2.5 pesos. However, the banks do not in practice use this for low value payments, like OFW remittances between banks. The current practice is to charge 150 pesos for interbank transfers. There is also limited inter-operability in the three bank-owned automated teller machines (ATM) networks for competitive reasons. Smaller rural banks and thrift banks which cannot afford PCHC membership and other “grass roots” financial institutions are not fully integrated into the formal payment system.

G. Legal and Regulatory Aspects

50. The non-bank courier companies are not regulated, which is in itself a major competitive advantage in terms of cost. They obviously provide no record keeping or know your customer function, but operate like bulk mail. Proper reporting requirements (FATF Standards), if implemented, would eliminate much of their competitive advantage in cost if not in reach.

III. EFFICIENCY ISSUES AND CONSTRAINTS IN SENDING COUNTRIES: “FIRST MILE PROBLEM”

A. Access to Banking in Sending Countries

51. Access to banking services in sending countries is a serious constraint on the volume of remittances in formal channels and on banks ability to control their costs.

B. Retail Payments Services and Sources in Sending Countries

52. This “First Mile” problem is especially acute in the US. There is anecdotal evidence that a substantial number of Philippine residents in the US still mail checks or postal money orders that take up to a month to clear given the Philippine banks collection and availability practices.

53. The most cost effective means to remit money cross-border is by electronic transfer between financial accounts. This is even more efficient if the accounts are intrabank, especially if there is a single accounting platform. PNB, for example, has such a system and can debit remitters accounts in the US and credit recipients accounts in the Philippines virtually instantly. It can also receive cash over the counter at branches or its money transfer subsidiary for credit to accounts in the Philippines at a somewhat higher cost due to brick and mortar and personnel costs. However, this is the exception. Automated interbank ACH or giro systems represent the cheapest means of interbank transfers, but are not typically employed for remittance transactions and lack cross-border connectivity.

C. Limitations to Market Access by Philippine Banks

54. Direct Philippine banking operating presence in key overseas markets is constrained by both regulation and costs to a total of 20 branches and agencies. In addition, PNB has a 30-office money transfer subsidiary.

55. The second most efficient way to remit money is through the international ATM system, where the remitter issues his beneficiary a duplicate foreign bank issued card for use at ATMs in the Philippines. There is anecdotal evidence that this is fairly common, if irregular practice.

56. Critically, this method requires that the remitter has a deposit money account or a payment card account. Many Filipinos abroad either lack access to financial accounts (status reasons or because foreign banks do not want them as customers) or bank with institutions that treat foreign remittances as a high cost “exception process” or simply do not offer the service. Total lack of remittance products is especially common across the US banking industry.

D. Correspondents and “Tie-ups”

57. Any transfer through the US correspondent banking system are likely to be both costly and subject to “bene deduct” pricing policies where the sending bank splits back-end charges with its correspondent.

58. The net result is that Philippine banks are highly dependent on “tie-ups” with ethnic businesses or correspondent banks whose charges they cannot control for their US business outside areas where they have brick and mortar.

59. “Tie-ups” in the Gulf include Saudi Arabian money changers and other non banks. Local banks rarely welcome Filipino remittance business, though Arab National Bank has a well-priced and efficient “tie-up” with PNB, which places its personnel in select branches and uses its own system.

E. Role of Money Transfer Businesses

60. The first mile problem varies greatly by geography and segment, but serves in some degree to explain the robust growth of Western Union and informal channels. Western Union is growing its \$3.2 billion global revenue base and \$1 billion in profits at over 30% per annum, yet estimates its current share at only about 12% of the potential market for remittances worldwide. This reflects the market gap created by the failure of banks in the sending countries to provide access to affordable, simple remittance products. Despite their relatively high costs, Western Union thrives on a strategy based on convenient access (hundreds of thousands of access points, simple processes, multiple service options) and massive investments in marketing and brand awareness (\$300 million per year). It should be recognized that many of the remittances now flowing to the developing world would not happen without non-banks and informal channels.

F. Legal and Regulatory Issues

61. Several types of “tie-up” represent potential record keeping and know your customer problems vis-à-vis FATF standard (money changers, ethnic stores, travel agents), even if the money at some point enters the Philippine banking system. Card associations are owned by regulated banks but are not regulated per se. The legal status of dual ATM cards as a payment method is unclear since it does not seem to have ever been contested. There are internet payment schemes such as Ikabo built around the dual ATM card concept. The Ikabo customer transfers money into a US account, which can be accessed through a US issued ATM card mailed by the company to a designated recipient in the Philippines. Other internet schemes allow funds to be charged to credit card accounts and withdrawn at ATMs in the Philippines. Although the global card networks are capable of supporting these transactions within their rules, the issue of distributing foreign bank issued payment cards in the Philippines appears open. It should be noted, however, that the MIF research indicates this practice is widespread in Latin remittance markets and ATM cards are relatively low cost in terms of interchange fees and foreign exchange spreads are standard and reasonable.

IV. EFFICIENCY ISSUES AND CONSTRAINTS IN THE PHILIPPINES: “LAST MILE PROBLEM”

A. Unbanked Population Constraints

62. The limited market research shared with us by banks seeking to enter the market and the consultant’s experience in other developing economies indicate that up to 80% of Philippine households are “unbanked” meaning they do not hold a deposit money account. Neither the BSP nor the Bankers Association of the Philippines have any hard data on the banked population, though about 16 million households are considered bankable by the card associations.

63. This is the heart of the “Last Mile Problem” in two ways.

- (i) The formal banking system is simply a set of deposit monthly accounts from which customers can access cash, and make or receive payments through a variety of access instruments including check, payment cards, and electronic transfers (ACH, GIRO, wire), etc. Households without deposit accounts in the formal system are economically “disenfranchised” because they can neither send nor receive deposit money through the banking system. Remittances are simply a class of person-to-person payments.
- (ii) The exclusion of the poor from the formal financial system limits their ability to efficiently manage their resources, save and establish sound financial habits. This, in turn, reinforces their poverty and makes it less likely they can use credit effectively.

64. It should be noted that Association of Bank Remittance Officers estimate that over 80% of deploying OFWs open a deposit account during their pre-departure formalities but they are a small fraction of the potential market. Anecdotal evidence suggests that most remittances sent to bank accounts are immediately taken out as cash or delivered by courier.

65. The failure of the banking system to develop economically viable means to “bank the unbanked” is a market failure typical of developing economies, where banks are narrowly focused on an affluent minority, and corporate and real estate lending.

B. Bank Network Constraints

66. Bank networks (both branches and ATMs) are highly concentrated in Metro-Manila, especially those of the major banks. Some 2,646 of 7,492 banking offices of all types (including, thrift, and rural banks) are in the National Capital Region, as are 2,497 of 4,412 ATMs.

C. Payment System Capillarity Constraints

67. Capillarity is the ability to move deposit money from account to account in the banking system. Small-sized thrift banks, rural banks and other “grass-roots” financial institutions are poorly integrated into the national and international payments system. There is a general lack of automation and technical capacity. Products beyond simple savings or home finance schemes are limited.

D. Rural, Thrift and Microfinance Segments

68. The Philippines possesses a wide range of local grass roots banking institutions ranging from the government owned Land Bank to microfinance institutions sponsored by NGOs in both rural and urban areas. To a large extent, these alternative financial institutions are complementary rather than competitive with the commercial banking sector since they serve locations and segments of the population, which probably cannot be economically served by traditional branch banks. However, these institutions require strengthening at the level of management processes and technology if they are to fully realize their potential as value creating end points for remittances. There is a general lack of automation and technical capacity. Products beyond simple savings or home finance schemes are limited.

E. Role of Couriers and Logistics Firms

69. Even the commercial banks make extensive use of courier firms and logistics companies due to the lack of account holding and capillarity in rural areas. Where the couriers have a front-end, as they do in many overseas markets, it makes little sense for remitters to send money through bank channels for end delivery, since the bank channel simply adds cost.

F. Financial Literacy and Behavioral Constraints

70. The vast majority of remittances either arrive in cash (banknote) form, or are quickly converted into cash for immediate consumption. Not only does this fail to increase the stock of investable or loanable funds in the financial system, but it fails to increase the financial responsibility and credit worthiness of receiving households. Microfinance organizations sponsored by NGOs and financial institutions (FIs) appear focused on small credit rather than savings and are dependent on grant finding and below market sources of funds. This all limits the “absorptive capacity” of the Philippine economy to leverage incoming remittances for development. Insofar as they are not used for immediate consumption, it appears that remittances finance housing, or are hoarded outside the formal financial system although this point requires further research.

G. Legal and Regulatory Aspects

71. The persistence of an overwhelmingly cash economy makes it harder to develop an effective CTF and AML regime. Regulatory power is not used to provide incentives to financial institutions to reach out to underserved segments.

V. INTERNATIONAL PAYMENT SYSTEMS

A. Deposit Money System

72. There are currently extensive efforts on the part of EU authorities to reduce the cost of cross-border retail payments within the EU largely through linking up national giro or ACH systems. The US ACH is being linked to Canada’s system and there are plans to extend it to Mexico. The ACH does not support a unique remittance transaction type, but once linked, remitters could simply authorize the beneficiary’s bank in another country to debit his account or if he had the beneficiary’s banking details he could send a direct credit transfer. ACH systems are currently under-utilized for retail payments generally, but recent innovations have allowed check and credit card transactions to be converted to much cheaper ACH transactions at the point of entry into the banking system or even at point of sale. Remittance applications should be explored. The international credit union movement has its own low cost giro called IR net, which is also under-leveraged for remittances. The Federal Reserve has targeted the Philippines for a direct ACH link as a result of the recent May 2003 state visit of Philippine President Arroyo to the US.

B. Payment Card System

73. Both Visa and Mastercard have ambitious payment system strategies utilizing smart-card technologies and security features originally designed for online shopping. Simple prepaid cards, such as those utilized in a PNB Seven-Eleven tie-up in Hong Kong and the US hold

some promises. The important point is that card systems work on interchange commissions which are ad valorem and need extensive infrastructure (point of sale devices, ATMs etc.), so they require extensive capital investments to deploy.

74. It should be borne in mind that funds stored on a prepaid card or chip card are not necessarily liquid reserves for the banking system. They are not necessarily superior to traditional deposit money systems and require high levels of initial investment, which may be difficult to justify under Philippine circumstances except in relatively high-income economies like Singapore.

C. Postal System

75. The Philippines, like the US, is one of the few countries where the post office is not a major player in the banking system. This is changing with the Philippine Postal Savings Bank determined to enter the remittance business with “cutting edge” technology that may or may not be deployable. More to the point, the International Postal Union supports a low cost remittance system called euro-giro and the U.S. Federal Reserve is building a link to it. The US post office already provides a low cost remittance service for Mexico. A few years ago, several Philippine banks received a request for information from the US post office concerning cooperation in remittances. This is a naturally low cost front-end in many sending countries. The Philippine Postal Savings Bank project envisions deploying point-of-sale (POS) devices and stored value cards in the broader Post Office network and an alliance with the Rural Bankers’ Association. However, the consultant was unable to obtain a copy of the business plan of the Canadian software provider, who is funding the entire venture.

D. Emerging Technologies

76. Besides various types of so-called “smart cards”, there is extensive interest in using the internet and cellular phones to send payments related messages. Cell phones are the most widely deployed electronic channel in the Philippines which is a leading market for low cost text messaging. Text messages can in principle be used to send secured payment instructions nationally and internationally. So called wireless payments technologies may be especially suitable for conditions in the Philippines.

VI. OPPORTUNITIES FOR THE PHILIPPINES

77. The Philippine authorities should work with the private sector, governments, and IFIs but especially with the organized Filipino communities overseas to pursue several clear goals.

A. Increase Net Remittance Inflows to Formal Sector

78. If the Philippines achieve targets of increasing use of the formal sector remittances by given the likely size of the informal sectors, flows through the formal banking system would be \$3.5 billion greater, at around \$10.5 billion.

79. Reducing transaction fees over 3–5 years to the IADB average target of 5%, which is not unreasonable given the lower starting point, would increase net formal sector remittances by about \$500 million per year.

80. More aggressive bank pricing can be expected to force down Western Union and other money transfer company prices, which could add another \$500 million to \$1 billion net remittances based on the Mexican experience.

B. “Bank the Unbanked”

81. A banked population is an indicator of development, which in turn facilitates development. Spain was 80% unbanked in 1960, and now has 90% of its population banked. Remittances played a major role in its development. Even Mexico is 63% banked. Banking in a modern economy is economic enfranchisement. The Philippines should aim to give the majority of households access to a simple, low cost deposit account within five years, including all recipients of remittances from abroad. This, together with increasing value, choice, and service through competition and technical innovations, is central to shifting remittances from informal to formal channels.

C. Increase Investable Resources in the Philippine Financial System

82. Positive incentives for non-resident Filipino (NRFs) to bank and invest in the Philippines are essential. This is not only a matter of providing significant tax advantages. 20% of Portuguese bank deposits are in non-resident accounts (which include free inward remittances services in many cases). Innovative private sector banks in India have created compelling products for non-resident Indians (NRIs). For example, ICICI Bank offers NRIs a complete range of methods for sending money back to India at low cost, either electronically through ACH transfers to its branches and correspondents overseas, or over the counter of partner banks in cash or check form. ICICI offers NRI account holders high interest Indian rupee accounts with the choice of currency upon maturity so that depositors are fully hedged against currency depreciation. NRIs can hold deposits and investments in a range of currencies and manage them over the internet.

D. Leverage Remittances for SME Development and Microfinance

83. Enabling the grass-roots institutions that serve the poor to provide efficient remittances services linked to tailored financial products (deposit, savings investment and insurance, not just micro-credit) is central to MIF’s institutional strengthening programs in Mexico and Central America. Creating a “service company” to run technology and treasury for thrift, rural and microfinance banks along the lines of BANSEFI should be considered. Microfinance institutions should be converted into regulated financial institutions to the extent possible, and subsidized credit should be phased out. Government programs to tap OFWs as investors in Government sponsored investment or savings schemes should be examined for their potential negative effect on the growth of a financially viable microfinance and SME grass roots institutional base.

84. Banco de Brazil has done a \$300 million securitization of inflows from Brazilian remitters in Japan, and remittances should be leveraged to give banks serving the poor access to market funds and capital. Remittance flows are highly stable and predictable, and can be used as collateral and leveraged to provide alternative development finance institutions access to commercial credit and the capital markets. Research by the Opportunity Microfinance Bank indicates that about one-third of its poor clients receive regular remittances, and many other bank clients believe they would if the process was more cost efficient. Remittances to the poor greatly exceed the total resources of the microfinance sector and can be pooled to finance more substantial enterprises than traditional microcredit.

E. Accelerate Use of Non-Cash Payment

85. Non-cash payment not only is less prone to attract criminal activity, but is more economically efficient. Conversion of remittances into deposit money or money purpose card accounts will help accelerate this global trend in the Philippines.

F. Enhance Revenue Sources of Formal Depository Sector

86. Remittances are a volume business with relatively high fixed costs. Even at lower prices, shifting a larger proportion of remittances into the formal sector represents a positive fee revenue opportunity.

G. Protect Consumers from Fraud and Excess Charges, Promote Formal Channels

87. Education, outreach, and consumer protection are active parts of IADB program, together with governments in the U.S. and Mexico. All informal systems are open to fraud and abuse, and the Philippines should address it aggressively here and in sending countries. The overseas Filipino communities need to be effectively mobilized for these efforts to succeed.

VII. RECOMMENDED COURSES OF ACTION FOR MULTILATERAL INSTITUTIONS

88. Development banks and other multilateral institutions can play a major catalytic role in optimizing the remittance markets in the Philippines and other Asian economies.

A. Develop Optimization Program for Remittances

89. Optimization of remittance flows is more than merely reducing their costs, important as that is.

90. Optimization means that factors like convenience, safety, regulatory compliance, and development impact as well as costs are enhanced, so as to attract larger flows of financial resources than would otherwise be the case. Optimization is focused on improving “formal” channels along multiple value dimensions to both sender and receiver, so that the market share of “informal” or “alternative remittance systems” declines through market forces.

91. Remittance optimization is achieved through multi-year programs and projects focused on competition, product innovation, and the improved use of technology and policy reform. However, optimization is a process of continuous improvement rather than a project or cluster of projects, and it needs to be sustained over long time horizons.

B. Key Processes and Outputs

92. Remittance optimization for a given country or region consists of six inter-related ongoing processes, each with a distinct output.

- (i) A detailed fact base needs to be developed on the remittance flows into a given country from both sender and receiver perspective. The business model, processes and economics of key remittance intermediaries need to be analyzed. The output of this process is a detailed process map, issue maps and key

metrics in a standard format for cross-country comparison. (Templates are attached as appendixes)

- (ii) Key cost drivers and barriers to efficiency need to be identified and their impact quantified and ranked. This needs to be done in detail for each sending country as well as on the receiving end, as well as payment system connectivity between and within countries. The output of this process is a “gap analysis” identifying and ranking by economic impact the key barriers to efficiency.
- (iii) To develop options to fill the gaps, a scan of payment system and technology innovations and best practices needs to be conducted and updated on a regular basis. An ongoing scan also needs to be conducted of legal and regulatory, policy and competitive changes impacting efficiency and costs. The output of this process is a current “library” of potential solutions for filling the gaps, as well as key constraints.
- (iv) The above analyses need to be translated into a remittance optimization strategy for a given country or region. The strategy will identify (i) key programs to stimulate private sector competition and innovation, (ii) key programs to address institutional and infrastructure weaknesses, and (iii) key policy reform and public sector coordination requirements. The output of this process is a strategy document to be syndicated among private and public sector entities with a stake in the remittance process. The strategy should have clear metrics for tracking progress over time, but its main function is to create a common view of the opportunity and challenges among key players in sending and receiving countries.
- (v) On a very targeted basis, with great care to avoid distorting competitive market dynamics, multi-lateral institutions should design and implement projects and programs where the strategy analysis would indicate that lending or technical assistance to private or public sector bodies would have a high impact on remittance optimization. It is likely that, as with IADB, such projects would link remittances with other development goals such as rural development and microfinance.
- (vi) To track progress towards optimization and establish accountability, there needs to be an ongoing feedback loop, where key metrics are tracked against targets in the country and regional strategies. The output of this process is an annual update on the Asian remittance market, which should form the basis of regional best practice forums, exchanges with government bodies and other IFIs, outreach programs to banks and other potential market entrants, and media coverage of remittances as a key topic in development.

C. Philippines as Template

93. For the reasons laid out above, the Philippines represents an ideal context for developing and refining a template for effective remittance optimization programs across the region.

ISSUES MAP

Host Country Issues

- ☀️ Segmentation by Demographics
 - 📦 Professional / migrants
 - 📦 Labor / contractors
 - 📦 Income class
 - 📦 Remittance activity
 - 🇵🇭 (Monthly / family support)
 - 🇵🇭 When / how much

- ☀️ Access to banking services
 - 📦 Philippine bank front end (“First Mile”)
 - 🇵🇭 Branch / agents
 - 🇵🇭 “TIE-UPS” – e.g., Al Raghi Banks, etc.
 - 🇵🇭 Western Union / Money gram
 - 🇵🇭 “Informal” – Travel Agents, Ethnic stores
 - 📦 Local banking system
 - 🇵🇭 Barriers to account holding
 - Price/document/status
 - 🇵🇭 Is Post office a remittance player
 - 🇵🇭 Card ownership?

- ☀️ Regulatory issues / barriers
 - 📦 To Philippine banks
 - 📦 To individuals

Banking System Connectivity Issues

- ☀️ Formal Bank Channels
 - 📦 Branch to branch book transfer capability (e.g., PNB)
 - 📦 Correspondent bank connections
 - 📦 Interbank GIRO in the Philippines
 - 📦 Cross border ACH

- ☀️ Card Associations
 - 📦 Visa debit products
 - 📦 Credit card applications

- ☀️ Money transfer companies
 - 📦 Bank tie-ups
 - 📦 Internal network

- ☀️ Postal banking
 - 📦 IPU
 - 📦 Euro GIRO

- ☀️ Emerging technologies
 - 📦 Mobile phones
 - 📦 Pre-paid cards (e.g. I-remit)
 - 📦 Internet (BPI Direct)

- (Matrix for country / segment)

- ☀️ Infrastructure gaps

Home Country Issues

- ☀️ Segmentation by Demographics i.e. where do workers come from)
 - 📦 Urban / rural
 - 📦 Banked vs. unbanked
 - 📦 Income strata
 - 📦 Dependents status
 - 📦 Remittance activity
 - 🇵🇭 How do they get the money?

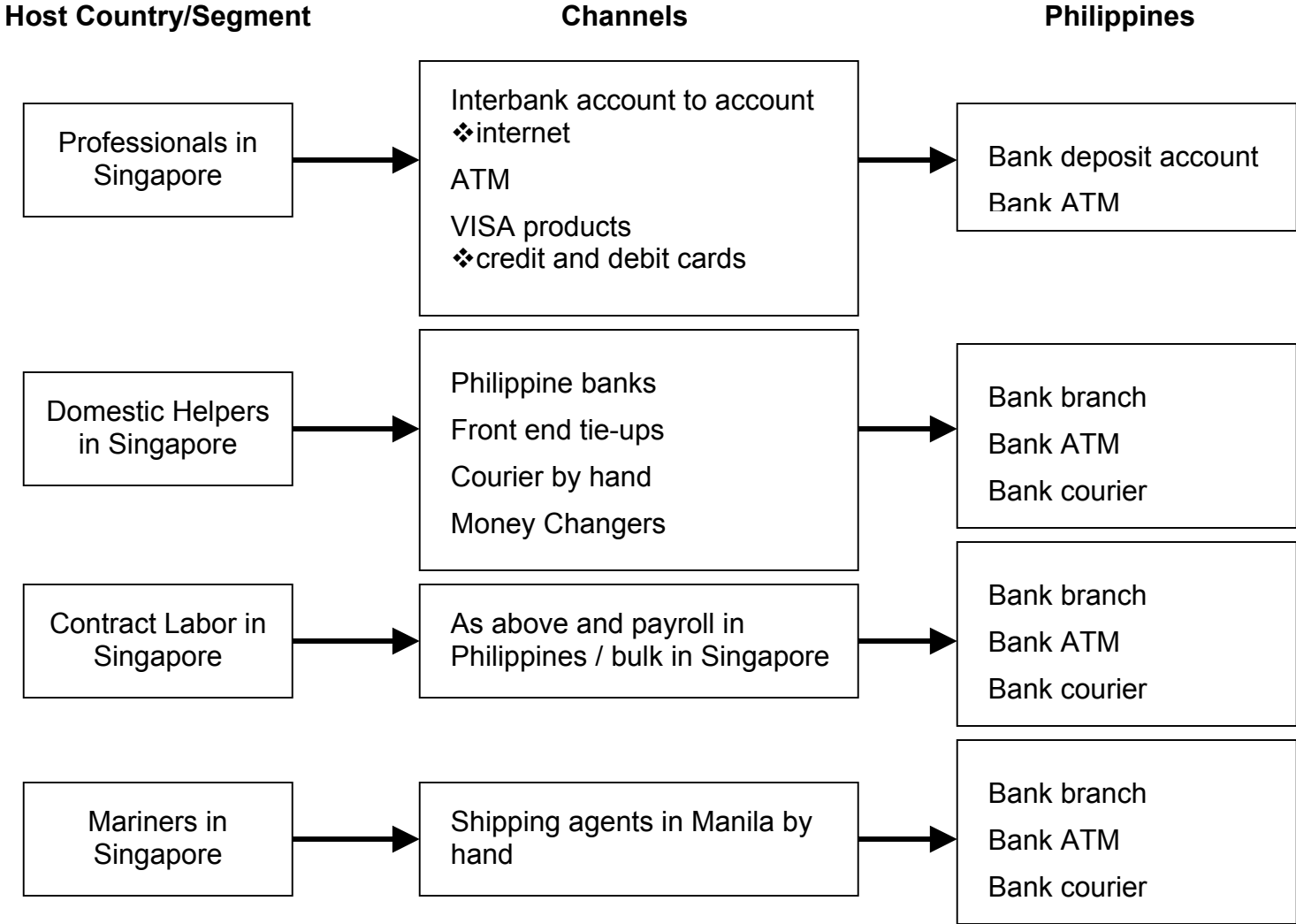
- ☀️ Access to banking services
 - 📦 Philippine bank back end
 - 🇵🇭 Outlets vs. workers home location
 - 🇵🇭 Products and price offered recipients
 - 📦 Couriers, shipping companies
 - 📦 “Hand to hand”
 - 🇵🇭 Consumption patterns, debt and savings
 - 📦 Rural banks, Post Office and other
 - 🇵🇭 State of coverage
 - 🇵🇭 State of capability
 - 🇵🇭 Technology, skills
 - 🇵🇭 Product out reach
 - 📦 Financial literacy / outreach
 - 🇵🇭 Departing workers
 - 🇵🇭 Dependents

- ☀️ Regulatory issues / barriers

KEY MEASURES

<p>Macroeconomic</p> <ul style="list-style-type: none"> Value of remittances to gross domestic product (GDP) — trends To domestic savings — trends To direct foreign investment — trends To development loans — trends To national debt — trends Cash intensity— M₁ cash as % of GDP/per capita Non-cash (M₂ M₃) vs. cash over time Consumer credit outstanding Consumer savings Consumer spending <p>Remittance Industry</p> <ul style="list-style-type: none"> Number of remittances estimate <ul style="list-style-type: none"> Amount, Frequency Range of estimates for remittance volume and value official returns vs. potential / informal — trends Range of prices: high – low — trends Composition of prices: front end – back end fees Number and share of competitors—commercial banks / others — trends Annual growth rates <ul style="list-style-type: none"> Workers abroad (OFWs) Remittances <p>Other Distribution Channels</p> <ul style="list-style-type: none"> Number of Point-of-Sale (POS) devices / density <ul style="list-style-type: none"> Telecoms: Land line access, long-distance access Telegraph companies outlets Mobile phones access Credit Card: Cardable population and % activation of carded population Number of credit card / capita (both debit and credit cards) Number of merchants, issuers, POS devices Postal Offices and Postal Savings Bank: Number of offices / % with IT connectivity for money transfers Geographical dispersion <p>Financial Systems</p> <ul style="list-style-type: none"> Number of banked households; % banked of bankable households Number of bank accounts/capita Number of bank branches/capita: urban versus rural 		<ul style="list-style-type: none"> Number of ATMs: urban versus rural Peso/\$ split on deposited remittances Access instruments <ul style="list-style-type: none"> Credit / debit cards ATM only cards Prepaid / phone cards Mobile phones Capital spending by banks Branch expansion / contraction Concentration <ul style="list-style-type: none"> % of customers in top 10 % of branches in top 10 % of remittances in top 10 Distribution of market cap / ROE of top 10 Number of Philippine branches and agencies by geography in <ul style="list-style-type: none"> United States (US) Asia Europe Middle East (ME) Philippine bank foreign currency accounts (nostros) at correspondents Number of ATM networks = 3 <ul style="list-style-type: none"> who and how many in each connectivity (if any), fees Interbranch clearing in banks Interbank (GIRO, check clearings) Credit card clearing (Visa, etc.) Electronic banking services in the Philippines <ul style="list-style-type: none"> How many offers Range of services Remittances? Cost ratio of the banking industry (top 10 commercial banks) vs. regional norms % of revenue and profits of banks contributed by remittance business Number of licensed money changers <ul style="list-style-type: none"> Courier companies Number of rural bank / credit unions / cooperatives / other outlets <ul style="list-style-type: none"> Charter limitations Technology limitations Exchange controls Capital controls Import Controls
---	--	---

SEGMENTATION SCHEME ILLUSTRATION



TRANSACTION FLOW MAP

