Session 11
Part III: Institutions and First Generation Policy: Regulation and Public Sector Intervention
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Guest Lecturer: Raul Hernandez-Coss, World Bank

Course Lecture

General Process

1. Structure of international money transfer operation:
    a. Sender goes to the point of sale (POS) – very likely a neighborhood establishment such as a small retail or grocery outlet or travel agency.
    b. Gives money to the retail worker. The POS may offer access to more than one money transfer service, in which case the shopkeeper often helps choose the MTO (money transfer operator) that the sender will use.
    c. Retailer calls MTO with the information and the money transfer order and begins the official money transfer process.
    d. Two streams of information. One is just data being sent to the destination country's paying agent informing the agent of the payment. Another stream represents the settlement – the actual money – which occurs at a later point in time.
    e. Money transfers occur immediately (or within hours) because the data that's being transmitted becomes a promissory between the two transacting institutions on either end - so money can be paid out based only on an instruction rather than actual moneys passed through the banking system. Most of the time, payment agents actually pay out money before they actually get any money.
    f. Actual transfer of money is too expensive to do for very small amounts, so distribution occurs less frequently, but in larger batches between banks.
    g. Or, in some cases, the transactions occur as netting exercises over longer periods of time. When a money transfer company maintains foreign currency balances abroad, importers in the country in question can also purchase foreign exchange from these same agents abroad for the purchase of goods abroad. Payments in the receiving country for unassociated services can also make up liquidity on the distribution side.
    h. Through arrangements between money transfer company and distributing agent's distributor bank, money settles with the payment agent within days.
    i. The counterparty risk is important. If the money transfer partner defaults or collapses in those days when payment is outstanding, then the distributor is left with an unpaid liability that may be large.
2. Where else might you see a public sector institutional role?
    a. Regulatory framework. Public sector sets the rules of the game: who can send; how much can be sent; how it is sent.
    b. Data collection. Public sector plays an important role in helping us track who is sending what and where.

c. First mile and last mile. Efforts to get senders to formalize remittances; by provision of information; regulations to make sending easier.
d. Civil society roles.
    i. Financial education
    ii. Lobbying
    iii. Migrant support
    iv. Information

Problems and Solutions

1. Various methods.
    a. MTOs still form the largest part of the market.
        i. In most corridors, MTOs are the fastest, most convenient and most reliable.
        ii. Customers are not price sensitive when there are few options.
        iii. When customers are comfortable with the options and there is more information, they will move to different methods that are less expensive.
        iv. Over half of respondents to Bendixen surveys indicate they believe they are paying too much for money transfers.
        v. Nearly half of respondents to Bendixen surveys indicate that recipients do not receive the full amount transferred or that they are unclear as to whether they have.
    b. Bank to bank transfers are a very small portion of the market.
        i. Demand and supply side constraints
        ii. Problems with accessibility and transparency
        iii. Many potential clients do not feel welcome in banks
        iv. Sometimes process of using the services is not very easy to understand.
2. Costs have fallen due in part to increased competition.
    a. Again, banks still represent a very small portion of the market. Large MTOs play an important role (at least 25% of most markets). Smaller MTOs are more dominant in Mexico after years of total domination by Western Union and Money Gram.
    b. Cash to cash transactions are still the predominant form of transfer.
    c. Mexico corridor has fallen to about a $10 range from approx. $25 five years ago.
    d. Over the past six years, money orders have formed a smaller section of the transfer market, whereas electronic transfers have increased substantially.
    e. In some markets, there are still big differences between disbursing in domestic or foreign currencies. Example: DR
    f. Some corridors still illustrate high prices or large variance in price depending on where money is sent from and to.
    g. Some MTOs price by percentage. This usually ends up being a very regressive pricing scheme: poor people who send smaller amounts pay higher percentages.
    h. Distribution points of MTOs give them a large advantage.

        i. Western Union has nearly 200,000 agents in 190 countries.
        ii. Money Gram has approximately 60,000 points of sale.
        iii. Less than 5% goes through banks or bank accounts.

3. Individual/Civil society response
    a. For a very long time, nothing was done to address the high costs of MTOs.
    b. Law suits were brought against some of the large MTOs:
        i. Class action law suits against First Data/Western Union for high and hidden fees, 1999.
        ii. On average, people were being charged $30 to make transfers, along with foreign exchange rates that were, on average, 10% lower than market rates.
        iii. Settled in 2002.
    c. 1995 – Wells Fargo begins the *Intercuenta Express* to Mexico. Probably not aimed at low income clients.
    d. 2001 – Second Federal Savings, Chicago – ATM card for Hispanics, first to accept the ITIN (Individual Taxpayer Identification Number) and *matricula* consular.
    e. Citigroup buys Banamex, thus becoming a larger player in Mexico.
    f. 2002 – Credit unions offer limited remittances services to non-members.
4. Since this time there are more creative responses:
    a. Spanish-speaking tellers
    b. Mobile branches
    c. Partnerships with national consulates
    d. Outreach
    e. Kiosks in grocery stores
    f. Aesthetics and amenities
    g. Cross-selling

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Bilateral Remittance Corridor Analysis

1. Importance of Remittance Flows
    a. Help alleviate poverty.
    b. Counter-cyclicality.
    c. Possibly improve creditworthiness of economies.
2. World Bank's Objectives
    a. Promote use of formal funds transfer systems to increase transparency and protect integrity.
        i. Many people think that all informal systems are all the same. In fact, they are very localized and very different.
        ii. People also associate informal systems with money laundering and terrorist financing. Also, certain countries have poor reputations for corruption, limiting the willingness of developed country banks to partner with them.
            1. For example, UK banks are very hesitant to associate with Nigerian banks for reputational reasons (eg. email banking scams sourced to Nigeria).
    b. Encourage the use of remittance transfers as a tool to increase access to financial services for both senders and recipients.
        i. Very important, but very difficult to accomplish.
        ii. Very few countries have specific national strategies on remittances.
        iii. The formal sector may not be as willing to accept the transfer as we may think – banks are not set up to profitably and efficiently process massive amounts of small transfers and may find the transformation too costly to undertake.
        iv. If remittances can be channeled through financial systems, there are multiplier effects:
            1. larger pool of deposits;
            2. increased lending and investment;
            3. larger GDP growth.
        v. Also important to remember that informal systems are not always very reliable.
        vi. "Access to Finance." This is project to increase access by poor people to financial systems. Remittances are seen as one method to draw in the poor.
3. Bilateral Remittances Corridor Analysis
    a. Remittance Service Providers:
        i. Individuals (cash-based transactions or cash-couriers)
        ii. MTOs
        iii. Bank-to-bank.
    b. Main component to reduce costs is competition. This was learned from the US experience.

c. All of these providers need networks (access points) in sending country and receiving country.
    i. Some governments are beginning to look at postal services because of their existing infrastructure.
    ii. Problem would be to make available the technological services that make MTOs able to do their transfers to the postal services.
d. Procedures to link access point to enable:
    i. Messaging – transfer of info about remittances
    ii. Settlement – transfer of funds themselves.
e. The World Bank has currently looked at 11 corridors.
    i. The purpose is to analyze various regions to distill commonalities and differences.
    ii. Finalizing case studies and drawing out lessons.
    iii. The results of these analysis can strongly affect both the public and private sector's interest and involvement in the remittance market.
f. **The key to formalizing flows is to understand what attracts senders and receivers to various channels. This varies from country to country, but it is clear that the key factor is reliability, not cost.**
g. Various Corridors looked at by the World Bank:
    i. US/Mexico
    ii. Canada/Vietnam
        1. During certain holidays we see spikes in remittance amounts: this can falsely alarm anti-laundering rules.
    iii. US/Guatemala
    iv. UK/Nigeria
        1. Approximately 100k Nigerians in the UK.
        2. Difficult to attract big banks because of small volume of transfers.
        3. Maybe attract interest of micro-lenders.
    v. Germany/Serbia
    vi. Qatar/Nepal
        1. highly formalized corridor
        2. highly controlled migration policy
    vii. Italy/Albania
        1. As a result of bad experiences with financial sector in Albania, there is a strong aversion to formal sending.

4. General Principles for International Remittances Services –
    a. Drafted by 10 central banks. This will now be a part of bank mission protocol when examining country's' banking systems.
    b. The Principles.
        i. Market for remittances should be transparent and have adequate consumer protection
        ii. Improvement to payment system infrastructure that have the potential to increase the efficiency of remit market should be encouraged

iii. Remit services should be supported by a sound, predictable nondiscriminatory and proportionate legal and regulatory framework
iv. Competitive market conditions, including appropriate access to payment infrastructure should be fostered
v. Remittance services should be supported by appropriate governance and risk management practices.

5. Policy Recommendations
    a. Consumer Needs
        i. Dissemination of information
        ii. Education on services
    b. Integrity and Regulation
        i. Incentives to shift to formal channels
        ii. Risk-based regulation that facilitate access at reasonable costs
        iii. Proportionate aml/cft reporting and monitoring
        iv. Common standards of regulation but implementation based on domestic conditions
    c. Increase access and reduce costs
        i. Leverage on payment system technology
        ii. Policies on competition – new services
        iii. Facilitate alliances, domestic and cross-border cooperation on infrastructure for remittances.

Questions:

First mile/Last mile suggestions for improvements, how many of these suggestions are generalizable?

The Bank has identified about six or seven suggestions that are generalizable. For example, need for improved data collection. This helps everyone: private sector gets more involved, public and individuals.

Are there differences between cultural backgrounds and payment incentives across the countries you've looked at?

More about incentives that in place, not about cultural background. There are some examples where cultural attributes are important. In Viet Nam, for example, it is preferable to receive money anonymously for of cultural reasons, namely, it is customary to be willing to make loans to family or community members when one has received money. As a result, it is easier to give recipients a means of receiving money discreetly.