

Session 12

Part IV: Second Generation Policy Response: Microfinance and Securitization

Guest Panelists: Sandra Reilly, Citigroup
Kai Schmitz, Micro Finance International Corp.
Nathaniel Jackson, IADB

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Course Lecture

Policy Responses

1. Successful business models in remittances
 - a. Large number and dispersion of access and distribution points.
 - b. Make use of social networks, which play a large part in determination of where an immigrant will send money.
2. Problems with current models
 - a. Many believe prices are still too high in money transfer companies.
 - b. Demand side constraints.
 - i. Formal financial sector, such as commercial banks, is still daunting for many immigrants
 - ii. Many feel they unwelcome in these institutions.
 - c. Supply side issues.
 - i. Formal sector is still having a hard time attracting users.
 - ii. Uncertainty about whether this segment is profitable enough.
3. Responses
 - a. Private Sector – beginning to get very interested in this large untapped market.
 - i. There have been a range of creative response to attract migrants (some have met with more success than others):
 1. Spanish-speaking tellers
 2. Mobile branches
 3. Partnerships with consulates
 4. Outreach at cultural events
 5. Kiosks in grocery stores
 6. Aesthetics and amenities
 7. Cross-selling
 - b. Public Sector
 - i. Interest piqued by the massive size of aggregated flows and the connection with migration and immigration policy.
 - ii. Public Sector role is primarily considered focused on regulatory actions, which can have dramatic impacts on almost every aspect of the remittance process.
 - iii. Public sector can participate in many other roles – data collection, information, consumer protection, supervision, etc.
 - iv. Examples
 1. Inter-American Development bank MIF

2. President Bush and Partnership for Prosperity
 3. FDIC and New Alliance Task Force
 4. Federal Reserve's *Directo a Mexico* - use of the Automated Clearing House.
 5. Mexican Government – *Profeco Quien es Quien* and *Condusef*
 - a. Improvement of data collection.
 - b. Providing information
- c. Civil Society
- i. Community Groups and immigrant advocates
 1. Can promote financial literacy and information about services and rights.
 2. Consolidate and represent immigrant interests.
 3. Can help financial institutions as intermediaries to clients.
 - ii. Business associations like NMTA
 1. Represent money transfer operators (MTOs). Recently, pieces of legislation like the Patriot Act have had deleterious effects on some MTOs.
 - iii. Receiving side groups
 1. Advocate for family rights
 2. Encourage and facilitate the productive use of remittances.
4. Broad Recommendations and Responses
- a. Lower prices – discussed at length earlier in the course.
 - b. Improve regulations
 - i. MTOs argue they face a skewed playing field
 1. The impact of post-9/11 regulatory behavior has been particularly damaging to money transfer operators.
 2. MTOs need bank accounts to conduct business.
 3. Lack of guidance or over-zealous supervision and audit of financial institutions that carry MTO bank accounts.
 4. Result: waves of bank account closures for MTOs
 5. Also, increasing costs of compliance on MTOs.
 6. MTOs argue that banks do not face the same level of scrutiny.
 - ii. Amount of disclosure depends on type of institution.
 1. Patriot Act and Bank Secrecy Act have created new regulations.
 2. All institutions must comply with Know Your Customer rules.
 3. But, banks, credit unions and MTOs may have differing standards of accountability.
 - iii. There are multiple regulatory agencies with overlapping mandates.
 1. Within the Treasury, the IRS, the Financial Crimes Enforcement Network (FinCen), also FDIC, Federal Reserve bank examiners.

2. State level supervision exists as well usually in the form of state banking departments.
- c. Improve data collection and information provision.
 - i. An ongoing effort that has produced increasingly better results and new initiatives (primarily public sector).
 - ii. *Condusef* in Mexico has created a web based program that would allow people to compare prices along various corridors. Problem was that internet penetration is very low among the target population.
 - d. Encourage inclusion. Many banks are attempting to increase services provided to lower income individuals. (discussed with private sector response)
 - e. New Products
 - i. There is a strong interest in applying new technologies to remittance transfers. For example, cell phone transfers, internet services and new kinds of bank cards.
 - ii. Technology needs to be appropriately targeted – for example, bank cards would not work in areas with no ATMs.

Guest Panelist: Sandra Reilly, Citigroup

Sandra Reilly

1. Citigroup has been involved with microfinance for over 20 years.
 - a. Citigroup defines microfinance as the provision of credit, savings, remittances and insurance services to poor and low income individuals not reached by the formal banking sector.
 - b. There is a major interest in banking the unbanked.
2. HSBC and Citigroup are among the most involved commercial banks in the remittance market (also Bank of America and Wells Fargo). They are located in many countries, but have not yet seen much volume.
 - a. Still much distrust by the poor and lower income segments.
 - b. They do not have massive networks on local and rural levels, as Western Union does.
 - c. They are only beginning to learn how to bring operational costs down. Most large banks were initially set up to handle much larger transactions where margins did not need to be as small as they do with small transactions.
3. Currently, the solution is to work globally with existing microfinance institutions, networks and investors as commercial partners and clients to expand access to financial services to unbanked and underserved.
 - a. In the US, it is relatively easy for Citi to bank the immigrant.
 - b. In the developing world, they are more interested in partnering with and providing wholesale services to micro institutions that have better access to the specific demographic.
4. Worldwide, banks have about 3-11% of the remittance industry – they lack infrastructure to run relationships and money transfer at the same time.
5. Banks could run a system like Western Union, but
 - a. There is a great deal of regulation that requires a totally integrated system in order to comply with the Patriot Act and other anti-money laundering laws. Citi is undertaking the overhaul, but it is a large undertaking.
 - b. It is a big effort to partner with other money transfer organizations in order to combine the relationships with the transfers.
6. Goals
 - a. Banking unbanked. This is the market of the future. The majority of lower income people are not in the formal banking sector. This is a huge untapped market that could, potentially, gain a great deal from inclusion.
 - b. Enrich the product offerings on both sides, first mile/last mile.
 - c. Use remittances to transition the unbanked in the formal sector.
 - d. Once the infrastructure is in place and Citi can begin offering a range of products to lower income people, the goal eventually would be to give transfer services for free.

Guest Panelist: Kai Schmitz, Micro Finance International Corp.

1. MFI Corp. sees its role as meeting a need in Latin America to bring integrated financial services to the underserved.
 - a. An interesting point is that most potential “clients” are located in **two** markets: Latin America and migrant destination countries.
 - b. Remittances seemed like the most obvious service part to link the two markets.
2. Since there are very few micro-finance institutions (MFIs) in the US, there was an obvious demand side need for MFI Corp. to fill. They now have about ten branches. These branches link the US to other countries.
 - a. Immigrants can build credit here in the US and transfer this credit overseas.
 - b. They are offering cross-border mortgages.
 - c. MFI Corp. can grant small loans for immigrants which help build credit with the bigger credit agencies.
3. Creating this infrastructure is very tech heavy. MFI Corp. has managed to create a tech infrastructure in Latin America, partnering with other micro-finance institutions.
4. The real objective:
 - a. Get large MFIs involved with MFI Corp.
 - b. Cross-selling of products.
 - i. First, offer check-cashing services.
 - ii. Second, maybe get the client to send money home with MFI Corp.
 - iii. At this point, MFI Corp. will have a significant amount of information about individual clients. Then they can begin to offer loans, use similar techniques used in MFIs (calling employers, neighbors). Then another loan which is bigger.
 - iv. Finally, an immigrant might be able to secure a mortgage in their home country or purchase health or life insurance.
5. Challenges.
 - a. Hard time knowing where to locate branches – where are the potential clients?
 - b. Regulations. In the US, MFI Corp. is regulated essentially as a bank. Very complicated regulations and bonding procedures.
 - c. Similar business issues as the MFI partners. But this helps work with their abilities. MFIs have a hard time doing real money transfer business, but as a bank MFI Corp. can help on this end.
6. The business is lucrative and development benefit – this is a rare bird.
 - a. Being able to combine remittances with a credit history is an incredibly important service. Credit cards are very important, but inaccessible to many people. This would be a critical service.
 - b. Many people are spending **8-10%** of their income on financial services. This is a huge number and MFI Corp. could help bring this down.

Guest Panelist: Nathaniel Jackson, IDB

Securitization of Remittances

1. Securitization is a way of harnessing illiquid assets or future flows of capital for current capital by creating a debt instrument.
2. Securitized Remittance Bond
 - a. Bond backed by future flows of remittances.
 - b. Different than an asset backed bond, because it is based on future flows.
 - c. These bonds can actually have higher ratings than sovereign bonds because funds flow from outside the country.
 - d. Remittance flows have proven to be very steady, even in down-turned economies (recall discussions of counter-cyclicality in previous lectures).
3. History of Securitized Remittance Bonds (SRB)
 - a. First deals were done during the 1994 Mexican Tequila Crisis.
 - b. Since then, more than 40 SRBs have done in Latin America.
 - c. Generally, they have had excellent track records. There has never been a late payment on an SRB.
4. Characteristics of an SRB
 - a. Composed of reliable future flows.
 - i. Composed of many small transactions, “granular.” Reliable, because diversified risk.
 - b. Collateral requirements will vary depending on flow, but require a high collateralization (4 or 5 times debt-service coverage ratio – much higher than asset-backed bonds).
 - c. Partial credit guarantee and/or subordinated tranche can enhance the rating of bond using securitization of remittances.
5. Benefits
 - a. Banks can access longer term financing.
 - i. Mortgages, for example.
 - ii. Helps dollarize banks assets.
 - b. Better ratings means cheaper funding – for example, more than 50bp from can increase in the credit rating or B or BB, which results in much lower interest rates.
 - c. Improve the asset liability management of local banks through access to longer term/lower rate funding sources.
 - d. For borrowers: banks can pass on savings from remittance securitization to its customers and clients.
 - i. Also, hopefully gets people into the banking system.
 - e. For investors: very low historic defaults in future flow transactions, so it is a more secure investment.
6. Transaction Structure
 - a. Set up a master account between several collecting banks. Collecting banks will send remittances through the master account.
 - b. The remittances then go through a trust or special purpose vehicle (SPV).
 - c. The SPV issues the bond.
 - d. In order to bring the bond up to investment grade, IDB will offer guarantees.

Questions:

How does being an MFI in the US help immigrants?

Answer from Kai Schmitz (MFI Corp.): By increasing access to the formal financial sector at a price that is much less than the alternative financial services that they currently use more frequently. Conveying information and promoting literacy for clients starts as soon as they walk in the door. However, it is a very difficult to communicate all the information and services available to the clients. Word of mouth and good service have been the best marketing.

Importance of credit history, what role have Citi and MFI played in promoting credit bureaus in foreign countries and incorporation of low income clients' histories in credit bureaus' databases?

Citi has not worked with credit bureaus, but are very active in trying to establish credit histories for clients. In the US, for example, if you bank with them or send remittances through them, they will create a \$500 credit limit. But they are having a hard time marketing this product.

MFI Corp: Part of their service is to send credit reports to other countries. MFI had a very hard time getting foreign credit bureaus to accept their credit reports.

How does MFI reach rural populations?

Citi is setting up various models. Banks will try to get into money transfer system more and more. One model is to hook into various networks, large and small banks, MFIs or credit unions. The model is a partnership model, where Citi will work on the sending side and they will find partners on the receiving side.