

Reducing Fees for International Remittances

The economies of developing countries rely heavily on money sent home by migrant workers. However, says Neil Burton, Director of Product Service Strategy at Earthport, this leaves the world's poorest nations counting the cost of keeping the money flowing and therefore raises issues for policymakers.

A Sizeable Market

According to the United Nations, between 1960 and 2005 the number of international migrants doubled, and in 2005 about 190 million people –about 3% of the world population- lived outside their country of birth¹. The prolific nature of informal remittance channels in many countries makes it difficult to estimate the total amount of funds remitted. However, estimates from the World Bank put the amount sent globally by migrant workers at \$443 billion in 2008². . Whilst much of the focus is on flows to developing nations – indeed the Migration Policy Institute (MPI) estimates three quarters of global person-to-person remittances are destined for the developing world. Flows into developing as well as developed nations can be very large, as shown here:

Country	Amount in billion USD ³
India	51.6
China	48.5
Mexico	26.3
Philippines	18.6
France	15.9
Spain	11.8
Germany	11.1
Poland	10.7
Nigeria	10.0
Romania	9.4

Figure 1: Top Ten Countries Receiving Workers' Remittances, Compensation of Employees and Migrant Transfers, World Bank data for 2008

Sending Costs Can Be a Significant Percentage of GDP

Frequently, the costs of sending money home are high – as much as 10-20% of the amount remitted - and in the last few years this has come to the attention of policymakers interested in encouraging remittance flows to the developing world. In a communiqué in July 2009, G8 development ministers called for the commission charged on making remittances to be halved, from the present average 10% to 5% in five years. The communiqué indicated that the measure would free up \$12 to \$15 billion for immigrants' home countries.

¹ United Nations 2006.

² World Bank 2009

³ World Bank 2009

Impact on GDP

The economics are compelling. For 31 countries, remittances amount both to over 5% GDP and more than \$1bn per annum. Indeed, in some of the world's smaller countries, such as Tonga and Guyana, remittances account for more than a quarter of GDP. The economic slowdown has impacted the rate of growth in remittances in many countries, notably in Central and South America, and has also made it harder for the poorest workers to afford the fees.

Fees charged are typically a significant percentage of these usually low value transfers. Fees are usually collected by service providers in the sending countries. The G8 countries are popular destinations for emigrants from developing countries; in fact, at least four of the G8 countries (France, United States, United Kingdom, Russia, Germany, Japan, Italy and Canada) appear amongst the top 10 most popular destination countries for people emigrating from 19 of those 31 countries⁴. Halving the fees for these 19 countries alone would generate over \$4bn per annum.



⁴ Earthport analysis, World Bank data

⁵ World Bank

⁶ <http://www.bis.org/publ/cpss76.pdf>

⁷ <http://www.smartypig.com/>

Remittances drive economic growth

Remittances are defined as the sum of workers' remittances, compensation of employees and migrants' transfers⁵. However, services which serve the remittances market are enablers for much wider, sustainable, economic improvement. 'From the point of view of those providing remittance services, remittance transfers will often be indistinguishable from any other low-value cross-border transfers, including small payments to and from businesses⁶.

The ubiquity of the mobile phone means that social networking and multimedia have also become ubiquitous. A beneficiary in a developing country holds the tools in his or her hand to advertise and promote goods and services globally. Funding can be attracted directly, internationally. Charitable contributions can be tapped in innovative ways; for example a school in the UK might run a sponsored event to raise funds for a project at a school in a developing country, and receive direct and regular feedback on the progress of the project, in the form of video posted on Utube. Online savings schemes such as Smartypig⁷ could be leveraged to collect funding for developmental projects.

Much of the innovation in mobile payments is occurring in countries outside the G8. Although most remittances are consumed for basic needs such as food and housing, an efficient electronic infrastructure serving the remittances market will soon drive further innovation – in ways we cannot yet predict. Already in 2008, the World Bank noted that the increase in remittances to South Asia, in particular India, was driven by a switch from consumption to investment, as exchange rate differentials and depreciating local currency encouraged overseas workers to make investments in their home country.

The 'Send Money Home' Model

Many remittance service providers base their services in countries which have a high immigrant population. Some providers focus on the most common bilateral 'channels', such as UK-India or US-Mexico. Others seek to provide global reach, often using specialist cross-border payments service providers. For example, Earthport plc delivers funds to over 200 countries globally. Earthport uses a business model interlinking the domestic payments infrastructures of the sending and receiving countries, resulting in a transparent, high efficiency and consequently low cost service.

Users of electronic remittance services generally enjoy charges which are already less than 50% of the current market average. The following chart illustrates the difference in charges between two providers for transmitting cash from the UK to Poland:

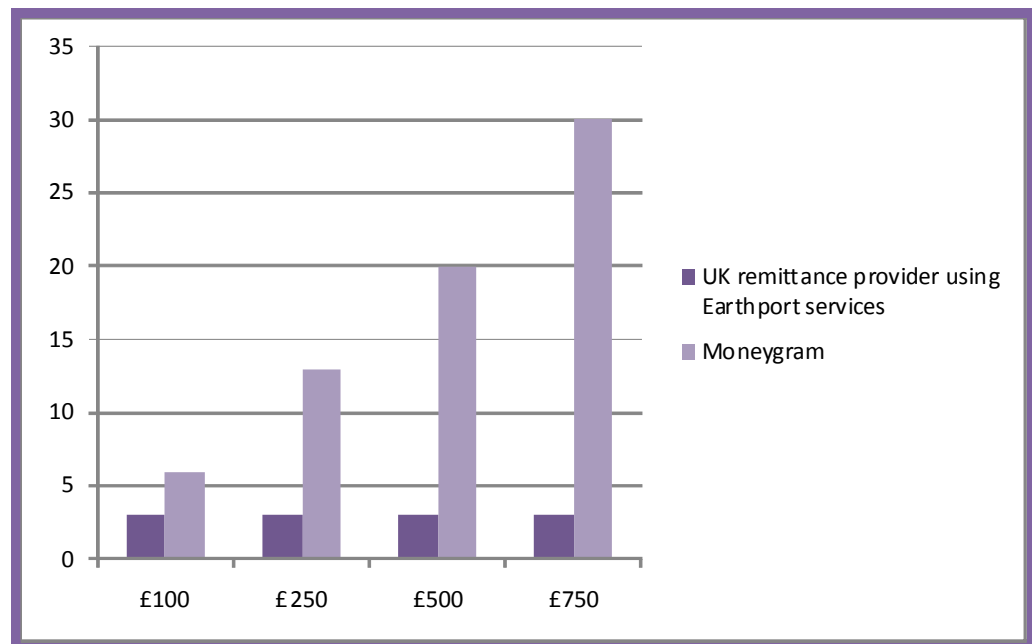


Figure 2: Comparison of Fees Charged by Money Transfer Providers UK-Poland

Whilst the above data may not be a like-for-like comparison between providers, it shows a wide disparity between the fees for different types of services. Of course, senders may wish to pay a premium for higher service levels; such as faster delivery, and delivery in cash to the beneficiary's door. World Bank statistics indicate that the average cost of sending money to Poland using money transfer organisations was £7.75 per transaction in the third quarter of 2009 for remitting amounts of up to \$500 equivalent⁸.

⁸ remittanceprices.worldbank.org/RemittanceCosts/?from=196&to=154

The 'Bring Money Home' Model

Some service providers target the diaspora of a specific country as its population spreads overseas. This 'Bring Money Home' model has a double benefit, because if the service provider is based in the economy of the receiving country, GDP can be increased by the amount of the fees collected, in addition to offering lower fees to senders.

For example, in Vietnam, remittances amount to nearly 8% GDP⁹. According to World Bank data, the average fee paid to send money home is close to 12%¹⁰ (and the average fee charged by banks is 17%). Fees are lower for senders in some countries (e.g. US to Vietnam) and higher in others (France to Vietnam). In round terms, nearly 1% of GDP is consumed in fees to send money home. If those fees can both be halved and collected by a Vietnamese institution, the potential benefit is both a fee reduction to the sender, and an increase in GDP of 0.5%.

'Bring Money Home' services can be targeted directly to nationals living overseas, in their local language and virally via the Internet and social networking, thus achieving high penetration for relatively little cost. Funds can be collected using the same methods as in the 'Send Money Home' model, using low-cost cross-border electronic credit transfers. Payouts in the destination country can be made through existing banking channels, such as ATMs.

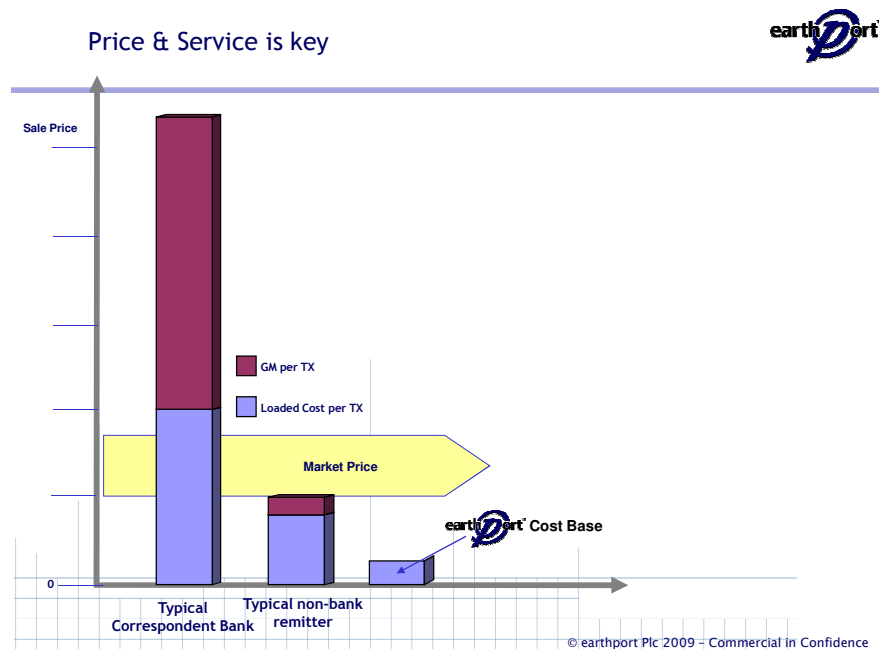


Figure 3: Price and Service is Key

Where available, other 'value delivery channels,' such as prepaid cards and mobile phone services, can also be used. By 'riding on the rails' laid down by others, investments and operational costs are kept to a minimum.

Some senders and beneficiaries may prefer the convenience or anonymity of cash, especially those who have limited access to banking services or have no bank account. However cash is an expensive money storage and transfer medium.

⁹ <http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1199807908806/Vietnam.pdf>

¹⁰ <http://remittanceprices.worldbank.org/RemittanceCosts/?from=0&to=202>

If used to send cash, service providers in the G8 must perform checks under KYC and OFAC regulations at the point at which funds are submitted, thus incurring additional overheads. These authentication processes are built in to the banking system and very largely automated, so senders remitting money from a bank account do not incur these additional overheads. Senders and beneficiaries are likely to obtain the best price and service level if they operate within the standard electronic banking services.

Regulators Have an Active Role to Play

Consequently regulators have a role to play in encouraging the banking industry to extend its reach, and encouraging those remitting funds to participate in the formal banking system.

1. Regulators and bankers in the G8 countries must reduce the regulatory barriers which discourage the unbanked from using the most efficient electronic services.

It is estimated that unregulated services such as Hawala, account for more than half of all remittances today. Regulated services need to become simple and accessible enough for Hawala operators and users adopt them.

2. Regulators must reduce barriers for service providers.

In Europe, the Payments Services Directive which came into force in November 2009 lowers barriers to entry for non-bank service providers, and imposes minimum service levels. However, in the US, which is the most popular 'sending country', amounting to over 10% of all remittances globally, a non-resident bank wishing to collect funds must obtain a licence separately from each state, before it can launch a Bring Money Home service. Wide variation in the regulatory requirements of bonding and net worth across 30 states in the United States would require bonds and net worth of nearly \$10 million¹¹ to start a money transfer business with offices in all these states. Such a large investment is a major inhibitor.

Harmonising and reducing the regulatory and reporting overhead should encourage greater competition. One way to achieve this would be to make a "passportable" collections licence available to banks or other firms which are fully regulated by the regulatory authorities in their home country. The new IAT rules which came into force in September 2009¹² improve automation of the necessary regulatory scrutiny for low-value cross border payments, and hence pave the way for barriers to entry to the electronic banking services to be reduced, thereby bringing more transactions into the financial system.

3. Regulators should also encourage the development of 'value delivery networks' in the receiving countries, in order to maximise financial inclusion.

In most developing countries, banking infrastructures are far less ubiquitous, accessible and convenient to use than in the G8 countries. Mobile phones and smartcards are demonstrably market-proven, cost-effective methods of getting value to the recipient, who can then convert to cash locally.

However, mobile payments and prepaid card schemes are expensive to set up. A remittances service alone is unlikely to cost justify the necessary investment in these alternative value delivery channels. Regulators may therefore wish to consider encouragement of local value delivery and exchange infrastructures in the emerging nations.

¹¹ <http://siteresources.worldbank.org/INTPROSPECTS/Resources/Onreducingremittancecosts-revisedMay12.pdf>

¹² <https://www.pnc.com/webapp/unsec/ProductsAndService.do?siteArea=/PNC/Home/Corporate+and+Institutional/Corporate+and+Institutional/Resources/NACHA/NACHA+Rules+Changes/NACHA+IAT+March+2009>

Countries which have developed extensive national value infrastructures will then attract complementary services and investment. For example, the Mpesa project in Kenya – which was 50% funded by UK DFID¹³ – subsequently attracted a global bank.

4. Regulators should encourage national payments policies in G8 nations explicitly to recognise and serve the large numbers of second generation nationals, many of whom have strong commercial and social ties to the emerging nations; as well as nationals who have business, residential and leisure assets abroad, or who have emigrated or retired abroad.

Typically, national payments policy is focused on domestic schemes and instruments. In the UK, the Payments Council's priority appears to be the elimination of domestic cheques¹⁴. Meanwhile, the approximately 10% of British nationals living overseas¹⁵, and the families of friends of UK nationals who are second-generation immigrants, continue to pay high fees and suffer poor service levels.

Summary

In summary, services capable of delivering at least 50% fee reduction are live and operating between the G8 and many of the emerging countries today.

However, without some degree of encouragement, mass adoption of these services and hence progress towards the goal of a 50% reduction in fees over five years is likely to be slow. Stakeholders whose commercial success is based on fee income dominate the market, and are unlikely to invest to change the model. The credit crunch has forced global banks to focus on cost reductions; innovation is on the back burner. Other stakeholders, such as the senders and beneficiaries are not sufficiently organised to generate the changes needed to drive mass adoption. Some degree of regulatory encouragement, along the lines outlined in this paper, is needed if the G8's goals are to be met.

¹³ <http://www.dfid.gov.uk/Media-Room/News-Stories/2007/M-PESA-1-million-Kenyans-bank-by-phone/>

¹⁴ <http://www.paymentscouncil.org.uk/files/National%20Payments%20Plan%20Executive%20Summary%20May%202008.pdf>

¹⁵ <http://news.bbc.co.uk/1/hi/uk/6210358.stm>



Earthport: Taking Local Payments Planet-wide

There's nowhere easier, cheaper or more reliable to make payments than in your own back yard. It's the cross-border payments that cause banks, businesses and consumers a real headache. Wherever possible, Earthport processes a payment like a domestic payment – saving on cost, cutting out hassle and reducing the time taken for funds to reach the ultimate beneficiary.

Using its extensive and unique global network of segregated accounts, the company offers a range of highly transparent payment services to banks and corporate clients. All you need to do is initiate the payment; our local accounts and virtual accounting engine will manage the rest: efficiently, securely and without fuss.

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