

## Reducing fees for international remittances

In a communique in July 2009<sup>1</sup>, G8 development ministers called for the commission charged on making remittances to be halved, from the present ten percent to five percent in 5 years. The communiqué indicated that the measure would free up \$12 to \$15 billion for immigrants' home countries.

The economics are compelling. For 28 countries, remittances amount both to over 5% GDP and to over \$1bn per annum. At least 4 of the G8 countries (France, United States, United Kingdom, Russia, Germany, Japan, Italy and Canada) appear amongst the top 10 destination countries for emigrants from 19 of those countries<sup>2</sup>. Halving the fees for these 19 countries alone would generate over \$4bn per annum.

The communiqué further also invited "all interested countries and stakeholders to join us in this effort." This paper highlights some regulatory issues which the G8 must address, if its goals are to be achieved.

### 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.

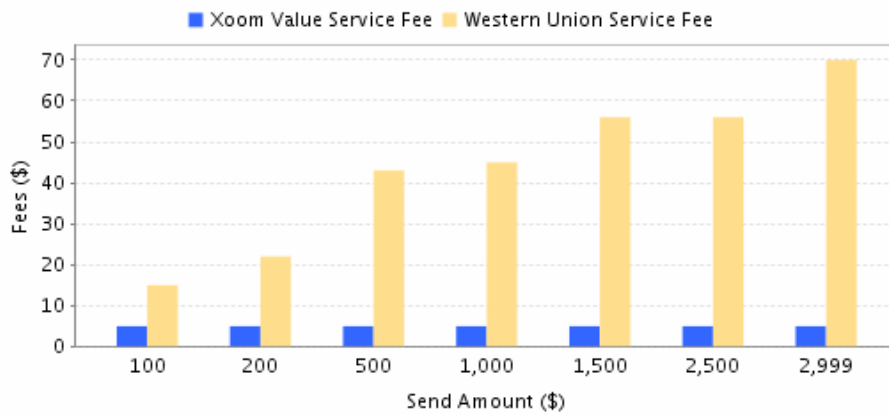
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<sup>1</sup>

<http://www.moneytransferint.org/index.php?pageID=2&type=member&newswireIssueID=3&newswireArticleID=23&newswireLink=cfsboheztmztlodowblbicncchnqitwgytihynxokjwmjlxm>

<sup>2</sup> Earthport analysis, World Bank data

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Source: Xoom website; remittances from USA to 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.

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### The Bring Money Home model

Some service providers target the diaspora of a specific country, This 'Bring Money Home' model has a double benefit, because if the service provider is part of 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

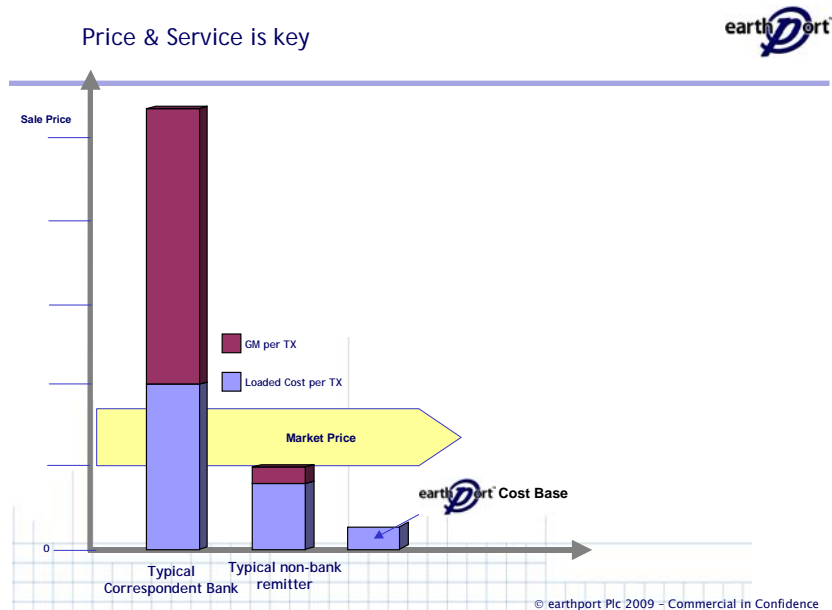
For example, in Vietnam, remittances amount to nearly 8% GDP<sup>3</sup>. According to World Bank data, the average fee paid to send money home is close to 12%<sup>4</sup> (and the average fee charged by banks is 17%). Fees are lower for senders in some countries (e.g. US to Vietnam), they are higher 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 the Diaspora, in their local language and virally via internet and social networking, thus achieving high penetration for relatively little cost. Funds can be collected using the same methods as in the 'Send' model, i.e. using cross-border electronic credit transfers, which are low cost. Payouts in the destination country can be made through existing banking channels, such as ATMs.

<sup>3</sup> <http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1199807908806/Vietnam.pdf>

<sup>4</sup> <http://remittanceprices.worldbank.org/RemittanceCosts/?from=0&to=202>

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Where available, other 'value delivery channels' such as prepaid cards and mobile phone services can also be used. Through 'riding on the rails' laid down by others, investments and operational costs are kept to a minimum. Some senders and beneficiaries may prefer cash, especially those who have limited access to banking services, or prefer the anonymity of cash, especially are financially excluded. However cash is an expensive money storage and transfer medium. If used to send money, service providers in the G8 must carry out regulatory processes including KYC and OFAC at the point at which funds are submitted, thus incurring overhead. These processes are inherent in the banking system and very largely automated, thus senders remitting money from a bank account don't incur additional overheads. Senders and beneficiaries are likely to obtain the best pricepoint and service level if they operate within the standard electronic banking services.

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

1. Regulators and bankers in the G8 countries must reduce the regulatory barriers which are too stringent to encourage the unbanked to use 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 that Hawala operators and users adopt them.

2. Regulators must reduce barriers for service providers. In Europe, the Payments Services Directive which comes 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 million<sup>5</sup> 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, for example by making a collections licence available, 'passportable' nationally, to banks or other firms which are fully regulated by the regulatory authorities in their home country, would encourage greater competition. The new IAT rules which come into force in September 2009<sup>6</sup> improve automation of the necessary regulatory scrutiny for low value cross border payments, and hence pave the way for these barriers to entry to the electronic banking services to be reduced, thereby bringing more transactions into the financial system.

#### Value delivery

3. Regulators should also encourage the development of 'value delivery networks' in the receiving countries, so as to maximise financial inclusion. In most developing countries, banking infrastructures are far less ubiquitous, accessible and convenient to use than in the G8. 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. 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 DFID<sup>7</sup> – 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.

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<sup>5</sup> <http://siteresources.worldbank.org/INTPROSPECTS/Resources/Onreducingremittancecosts-revisedMay12.pdf>

<sup>6</sup>

<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>

<sup>7</sup> <http://www.dfid.gov.uk/Media-Room/News-Stories/2007/M-PESA-1-million-Kenyans-bank-by-phone/>

Typically, national payments policy is focused on domestic schemes and instruments. In the UK, the Payments Council's<sup>8</sup> priority is the elimination of cheques. Around 10% of British nationals live overseas<sup>9</sup>.

### Remittances drive economic growth

Remittances are defined as the sum of workers' remittances, compensation of employees and migrants' transfers<sup>10</sup>. 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 businesses<sup>11</sup>'.

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 projects progress, in the form of video posted on Utube. Online savings schemes such as Smartypig<sup>12</sup> 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, an efficient electronic infrastructure serving the remittances will soon drive further innovation – in ways we cannot yet predict.

### 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 5 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

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

<sup>9</sup> <http://news.bbc.co.uk/1/hi/uk/6210358.stm>

<sup>10</sup> World Bank

<sup>11</sup> <http://www.bis.org/publ/cps76.pdf>

<sup>12</sup> <http://www.smartypig.com/>

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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.

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