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Insights

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Department

Remittances:

A Gateway to Banking for Unbanked Immigrants

Abstract: This edition of Insights examines the role of banks in providing money transfer services and reviews the goals of banks in offering these products. It describes how banks can use these products to attract unbanked immigrants into the banking system and become providers of a variety of financial products and services that immigrants can use. It addresses some of the key risks and regulatory issues presented by bank involvement in these products, as well as structural and cultural barriers to the growth of bank remittance products. Although immigrants in the U.S. remit funds to countries throughout the world, this analysis addresses the Mexican market because it is the largest and where banks have focused most of their attention.

I. What Are Remittances?

Remittances are the funds that immigrants¹ send to their home countries, typically to help support relatives. Remittances are sent worldwide through a variety of channels, with specific remittance methods being prevalent for particular countries or regions. A number of factors influence the channels used, including:

- The existence of a modern banking system and financial infrastructure.
- The efficiency of the delivery system.
- The educational and income status of the sender and recipient.²

Remittances from the United States to Latin America are sent predominantly by non-bank money transmitters, and a much smaller, but growing percentage are sent by banks. Despite the findings that only 3 to 11 percent of remittance traffic to Mexico is initiated at a bank,³ and that only 22 percent of Mexicans have bank accounts, 43 percent of remittance recipients in Mexico currently go to a bank to obtain their funds because banks in Mexico act as disbursing agents for

¹ Foreign-born persons in the U.S. who remit money to their home countries may or may not technically be immigrants — those who will settle permanently in the U.S. However, for matters of simplicity, this paper refers to these foreign-born persons as immigrants.

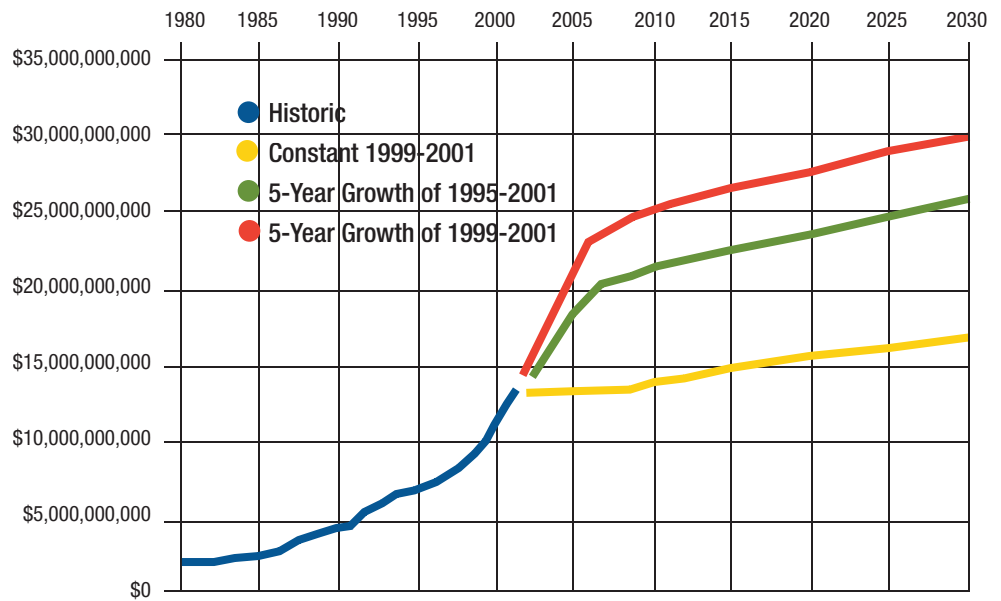
² Manuel Orozco, “Remittances and Markets, New Players and Practices,” in *Sending Money Home*, edited by R. de la Graza and B. Lowell, Rowman and Littlefield Publishers, 2002, p. 126.

³ Estimate of 3 percent appears in M. Orozco, “The Remittance Marketplace: Prices, Policy and Financial Institutions,” Pew Hispanic Center, June 2004, p. 1. Estimate of 11 percent appears in Roberto Suro, “Remittance Senders and Receivers: Tracking the Transnational Channels,” Multilateral Investment Fund and Pew Hispanic Center, Nov. 2003, p. 3.

money transmitters.⁴ The percentage of Mexicans who use banks to withdraw funds appears to be declining, however, as the wire transfer companies are finding that non-bank distributors in Mexico charge lower fees to remittance recipients.

Data collected by the Inter-American Development Bank suggests that in 2002, U.S. consumers sent more than \$30 billion to family and friends in Latin America, with one third of that amount flowing to Mexico. Although this *Insights* focuses on remittance products that are available to send money to Mexico, it is notable that on a relative basis, there has been a dramatic increase in remittances to South America.⁵ Figure 1 below shows remittance patterns to Mexico and Central America projected through 2030.

Figure 1
Remittances to Mexico and Central America
Received and Projected 1980 to 2030



Source: Billions in Motion: Latino Immigrants, Remittances and Banking, Pew Hispanic Center, Nov. 2002, p. 20.⁶

⁴ Roberto Suro, "Remittance Senders and Receivers: Tracking the Transnational Channels," Multilateral Investment Fund and Pew Hispanic Center, Nov. 2003, p. 12.

⁵ In 1999 remittances to Mexico represented 50 percent of all remittances to Latin America, but by 2002, had declined to one-third. See Manuel Orozco, "The Future Trends and Patterns of Remittances to Latin America," Inter-American Dialogue, October 2003, p. 2.

⁶ These projections were prepared in 2002 by the Pew Hispanic Center. Three scenarios were contemplated yielding a low, medium, and high set of estimates: **Constant 1999-2001** – the 1999-2001 *per capita* rate (remittances divided by the foreign-born population in the U.S.) is assumed to apply to projected immigrant populations; **5-Year Growth of 1995-2001** – The average rate of *per capita* growth from 1995 to 2001 will hold for another five years into the future; **5-Year Growth of 1999-2001** – The rapid average rate of *per capita* growth of 1999-2001 will hold for another five years into the future. However, even the highest projection done in 2002 underpredicted 2003 by about \$2.5 billion. Accounting for remittances is subject to significant measurement error, and forecasts from trends for the immediate future will remain speculative on a year-to-year basis.

II. Why Are Remittances of Interest to Banks?

Nearly all of the banks interviewed explained that their goal is to nurture lasting banking relationships with immigrants who use remittance products, by offering a variety of consumer banking products as immigrants become familiar with the American banking system. Many immigrants who arrive in the U.S. from Mexico do not have banking relationships, and a number of banks believe that by offering remittance products, they will have an entry to cross-sell a variety of other bank products to these consumers. The banks believe that their remittance products allow them to introduce a key service to a consumer paying a higher price for the product elsewhere, and that this introduction to the banking system will give the bank an opportunity to offer other financial products and services to, and thereby expand its business with, these customers.

A number of banks expressed satisfaction with the new checking and savings account customers they had developed because of the remittance product. Discussions with bankers and industry observers indicated that during an 18-month period between September 2002 and March 2004, remittance products generated approximately 400,000 new accounts for the largest banks offering remittance products. Those large banks that have introduced a remittance product more recently generally expect to reach 100,000 new checking or savings accounts within a 12-month period.

Many banks, especially those located in areas with significant Hispanic populations, have devoted major resources to capturing a share of the growing Hispanic market. And banks are not alone in their pursuit of Hispanic consumers. Marketing to this segment of the U.S. population has increased dramatically as the nation's Hispanic population rose by nearly 60 percent between 1990 and 2000. Hispanics now make up 12 percent of the U.S. population, about the same as African-Americans, and persons born in Mexico constitute nearly 60 percent of the Latin American born population in the United States.

Consumers acquire a variety of benefits from using bank-offered remittance products. As shown in Table 1, the cost of bank-offered products, on average, is less than those of other providers. Banks and other financial institutions generally offer remittances at lower costs than other providers and provide greater security.

Table 1
Charges to Transfer Remittances to Mexico

Method employed	Dollar charge (fee and exchange rate differential)
Debit card withdrawal at ATM (single bank model)	\$6.06
US-based bank remittance with pickup at Mexican bank (bank joint arrangement model)	\$15.70
Money transmitter model (Western Union)	\$19.03
Traditional wire transfer	\$39.75

Source: Manuel Orozco, "Changes in Atmosphere? Increase of Remittances, Price Decline and New Challenges," Inter-American Dialogue Research Series, March 2003, pp. 5-7. Charges are based on remitting \$300 to Mexico.

Banks have designed their remittance products to be profitable on a stand-alone basis. However, although fee income is important, banks generally acknowledge that they will not achieve the level of profitability they hope to attain until they cross-sell additional products to these customers. Some banks have developed accounts, designed specifically for recent arrivals to the U.S., that can be easily linked to a remittance product. A number of these are fully electronic or “checkless” transaction accounts that include debit cards.

Market research has found that it takes 6 to 18 months for an immigrant to get established with a job and repay any immediate debts before heavy remittance activity begins. Heavy remittance activity then continues for about 7 to 10 years, when the person either returns home, or establishes more permanent roots in the U.S. Even if a person returns home, he may have already brought other family members to the U.S. who will remain here. Those who stay are likely candidates for a growing variety of loan products and, at that point, banks want to have already established a relationship with the consumer.⁷ Regardless of how long immigrants stay in the U.S., they are likely to arrive without having any banking relationships, and thus are candidates for a whole range of bank products and services throughout their period of residence in the U.S.

III. How Do Remittances Work?

There are currently two major models for bank involvement in small denomination remittances to Mexico. In one model, typified by larger institutions, banks have developed joint arrangements with Mexican banks allowing for account-to-account transactions.⁸ In the second model, typified by smaller institutions, banks issue additional ATM cards that can be used to withdraw funds, but not make deposits, in Mexico. The leading money transmitters provide a separate model. Other models also exist, including bank relationships with money transmitters and Internet money transmitters.

Joint Arrangements with Mexican Banks

These relationships use an account-to-account transfer to help minimize the cost of the transaction. Typically, the bank in the U.S. will establish a transfer account that is linked to a customer’s checking or savings account. However, at least one bank will set up a transfer account that is linked to a remittance sender’s nationally branded (Visa or Mastercard) debit or credit card if the customer does not have a bank account. The transfer account will have a product name that the bank publicizes. Banks generally provide a monthly statement that details activity on the transfer account and allow account holders to check their balances at an ATM, by phone, or over the Internet.

To remit funds to Mexico, a customer transfers a dollar amount from his or her bank account or debit/credit card to the transfer account. Loading funds into the transfer account can be accomplished by telephone, over the Internet, at an ATM, or at a bank branch. The transfer account usually carries the proprietary name of the bank’s remittance product.

When the transfer account is opened, either the bank in the U.S. or the bank in Mexico (depending on the product) sends an ATM card to the designated person in Mexico. The ATM card that the recipient uses may carry the brand of either the U.S. bank or the Mexican bank. The personal identification number (PIN) is either mailed separately from the card, or it is given to the remittance sender who then provides it to the recipient. Once both have been received, generally

⁷ These observations were presented by Roberto Suro of the Pew Hispanic Center during an interview.

⁸ Products that require both the sender and recipient to use a bank account are known as account-to-account products, products that require the sender to use a bank account but distribute the funds in cash are called account-to-cash products, and products in which the sender brings cash to one location, and cash is in turn supplied to the recipient are referred to as cash-to-cash products.

within 15 days of the account being opened, the ATM card can be used. The recipient has access to the funds only in the transfer account, and not in any other of the remitter's accounts at the bank.

Banks assess a fee ranging from \$5 to \$10 each time funds are loaded into the transfer account, and the bank earns a spread on the interbank foreign exchange rate. Some products sweep funds overnight from the transfer accounts to an omnibus account at the Mexican partner bank, while with others, the funds are available in Mexico within minutes. The recipient can then access the funds at an ATM in Mexico. If the ATM card also has debit card capability by having a Visa/Visa Electron, MasterCard/Maestro, or other network brand,⁹ the recipient can also make purchases where those cards are accepted. There is generally no fee for withdrawals if made at the partner bank's ATMs, but fees are likely to be charged if ATMs owned by other institutions are used.

The logistics of how the funds are transferred and held by the banks in the U.S. and Mexico vary among institutions. With some products, the exchange rate is set on the day the funds are transferred, while for others, the rate is set when the funds are withdrawn in Mexico.

Single Bank Model

Smaller banks have been able to develop cost-effective small denomination remittance products by issuing additional ATM cards and allowing U.S. customers to set up two accounts. These banks may issue an additional ATM card to an account holder in the U.S., and the account holder takes responsibility for delivering the ATM card and PIN to the recipient in Mexico. Since this method allows the recipient to access the entire amount in the account, some banks encourage customers to set up a secondary account. The customer can then periodically transfer the amount that they want the recipient to be able to access into the secondary account, which is the account to which the ATM card sent abroad is connected.

Money Transmitter Model

Cash-to-cash products offered by the leading money transmitter companies account for the largest share of the remittance market to Mexico. In this model, more intermediaries play a role as compared to the bank models described above. These players include the:

- Money transmitter.
- Agent that the money transmitter uses to reach the remittance sender.
- Agent that the money transmitter uses to reach the remittance recipient.
- Financial institution used to access the payments system.

A money transmitter may operate its own store or may choose to have its services available through existing retail establishments, such as grocery stores, convenience stores, and check cashers. Most money transmitters choose to operate through contracts with retail stores and can, therefore, have an extensive distribution network in the countries in which they operate. This model provides a wide market presence for the leading money transmitter companies.

The agents with whom the money transfer business contracts to provide its services receive a commission or fee for the transaction. In some countries such as Mexico, major banks commonly serve as distributing agents for the money transfer businesses. However, at least in Mexico, money transfer businesses are trying to reduce their reliance on banks as distributors, since the fee charged by banks in Mexico to disburse funds is greater than that charged by other retail establishments.¹⁰

⁹ Visa Electron and Maestro are the brands of Visa and MasterCard that are issued by banks in Mexico.

¹⁰ Much of the information on the money transmitter model is found in Manuel Orozco, "The Remittance Marketplace: Prices, Policy and Financial Institutions," Pew Hispanic Center, June 2004, pp. 4-6.

Other Models

Although most large bank products originally required the remitter to have an account at the bank, some also offer products, through arrangements with a money transfer operator, that allow non-account holders to bring cash to a bank branch to be sent abroad. Such an arrangement enables the bank to offer a cash-to-cash remittance product with an extensive distribution network abroad, in addition to other account-based remittance products that the bank may offer. Generally the products that allow cash-based transfers are used to send smaller amounts of money more often than the amounts sent through account-to-account transfers.

One large bank has a worldwide joint arrangement with an Internet firm that offers an on-line person-to-person electronic payment product and a separate relationship with a money transfer operator to provide a remittance service when the recipient does not have a bank account.

IV. What Are the Key Risks and Regulatory Issues Presented by Remittances?

Financial institutions must address a number of legal, compliance, and operational risks in offering remittance products.

Money Laundering

Remittance products can present a money laundering risk because they allow quick, inexpensive international transmission of funds and may provide an uncertain audit trail. In addition, both the purchasers and beneficiaries of remittances are not necessarily required to have a bank account and therefore may not be subject to customer identification procedures. Finally, the beneficiaries of ATM or debit cards may pass these instruments to others, about whom the bank may not have any information.

Banks have initiated various combinations of controls to limit the risk of money laundering in connection with remittances. The adequacy of particular controls will depend on the type of remittance product being offered and the strength of individual controls or the combination of controls used.¹¹ Some specific controls include:

- Limiting the amount of funds that can be deposited or withdrawn daily and/or monthly.
- Limiting the maximum balance on an account/debit card.
- Limiting the number of cards that can be tied to the account.
- Instituting monitoring programs to identify address matches, multiple accounts with the same beneficiary, accounts with large balances or high transaction volumes, accounts through which large amounts of money flow, and other unusual activity.
- Controlling the mailing of debit cards or the distribution of funds to recipients.

Various reporting requirements also may be applicable particularly if suspicious patterns of use of remittances emerge. The Bank Secrecy Act requires banks to file a Suspicious Activity Report (SAR) within 30 days if the bank suspects suspicious activity involving any transaction or pattern of transactions of \$5,000 or more.¹² In addition, Treasury Department regulations require financial institutions to file a Currency Transaction Report (CTR) within 15 days whenever a transaction or series of transactions involves more than \$10,000 in currency during one business day.¹³

¹¹ See the Comptroller's Handbook, "Bank Secrecy Act/Anti-Money Laundering," Office of the Comptroller of the Currency, December 2000, at <http://www.occ.treas.gov/handbook/bsa.pdf>.

¹² 31 CFR 103.18 — Financial Recordkeeping And Reporting Of Currency And Foreign Transactions, Reports by banks of suspicious transactions and 12 CFR Part 21.11 – Suspicious Activity Report

¹³ 31 CFR 103.22 — Financial Recordkeeping And Reporting Of Currency And Foreign Transactions, Reports of transactions in currency.

Banks also provide banking services to money transmitters, with some banks providing banking services to foreign money transmitters. Because that line of business can carry significant money laundering risks, OCC supervisory guidance advises national banks to perform careful due diligence of the accounts of money transmitters to control money laundering and reputation risks.¹⁴

Also, many money transmitters are “money services businesses” (MSBs) for purposes of the Bank Secrecy Act.¹⁵ MSBs are required to register with the U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN). The list of registered MSBs is available on FinCEN’s Web site.¹⁶

OCC supervisory guidance notes that high-risk customers (MSBs have traditionally been identified as high-risk entities) warrant enhanced customer due diligence at account opening and ongoing transaction review.¹⁷ This guidance therefore advises that national banks should verify the registration and licensing status of any money transmitters with whom they do business, and should consider obtaining and reviewing the following information on the money transmitter:¹⁸

- Financial information, including primary lines of business and major customers, and local reputation.
- The money transmitter’s anti-money laundering policies, procedures, and controls.
- Third-party references and information from verification services.
- Information on the owners of the business.
- The money transmitter’s license, including any restrictions.
- The purpose, source of funds to open the account, and expected activity.

OCC supervisory guidance also advises that, in addition to considering risk to its reputation, a bank should weigh the type, patterns, and volume of activity in the account.¹⁹ The guidance further advises national banks to file a SAR if the bank suspects that a customer is an unlicensed or unregistered money transmitter, and to carefully consider whether to provide (or continue providing) services to such an entity.

Customer Identification

The Customer Identification Program (CIP) rule implementing section 326 of the USA PATRIOT Act²⁰ outlines procedures for banks to follow in order to verify the identity of a customer who opens an account.²¹ Prior to opening the account, the CIP rule requires that, at a minimum, the bank request the name, address, date of birth, and U.S. taxpayer number from the individual

¹⁴ See Advisory Letter 2004-7, Bank Secrecy Act/Anti-Money Laundering: Guidance on Money Services Business Customers, Office of the Comptroller of the Currency, June 4, 2004.

¹⁵ See glossary for definition of “money services business.” Complete definition is available at 31 CFR 103.11(uu).

¹⁶ See http://www.fincen.gov/msbregistration_introletter.pdf or the money services business section of the FinCEN Web site at <http://www.msb.gov>.

¹⁷ “Money Laundering: A Banker’s Guide to Avoiding Problems,” Office of the Comptroller of the Currency, Dec. 2002, p. 16.

¹⁸ See Advisory Letter 2004-7, Bank Secrecy Act/Anti-Money Laundering: Guidance on Money Services Business Customers, Office of the Comptroller of the Currency, June 4, 2004.

¹⁹ Ibid.

²⁰ See 31 CFR 103.121. The federal financial regulatory agencies also jointly issued frequently asked questions regarding customer identification programs (CIP). They are available at <http://www.fincen.gov/finalciprule.pdf>.

²¹ If the customer purchases a remittance product that does not require an account, other identification and verification requirements may apply. See e.g. 31 CFR 103.33(e) (any funds transfer of \$3000 or more).

opening the account. If the individual is not a U.S. citizen, the bank may obtain the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. Within a reasonable time after the account is opened, the CIP rule requires the bank to verify the customer's identity by asking to see some form of identification, such as a driver's license or passport or by using a non-documentary form of identification.

The CIP rule neither endorses nor prohibits bank acceptance of information from particular types of identification documents issued by foreign governments, such as the *matricula consular*. Instead, a bank must decide for itself, based upon appropriate risk factors, whether the information presented by a customer is reliable.

The CIP rule generally does not require the identification or verification of signatories to or beneficiaries of an account. Although some U.S. banks obtain detailed information on the beneficiaries of remittances similar to what is required for account holders, others do not investigate the identities of the recipients in Mexico, but leave that task to the partner bank in Mexico. Generally, U.S.-based banks consider beneficiaries of remittances to be either customers of a Mexican bank or merely a party with whom the remittance sender has a relationship.

The USA PATRIOT Act also requires a bank to check the names of the U.S. bank customer and the recipient in Mexico against Office of Foreign Assets Control (OFAC) screens²² to ensure that the funds are not supporting known terrorists, foreign nationals, or other parties with whom U.S. residents are prohibited from engaging in financial transactions.²³

Country Risk

Since remittances are a cross-border product, foreign-based service providers will be involved at some point in the transaction. As a result, a bank may be exposed to country risk, which is the possibility that economic, social, and political conditions and events in a foreign country might adversely affect the bank. Such conditions and events could prevent the foreign-based service provider from being able to process payments as expected.

OCC supervisory guidance therefore advises national banks to manage country risk by monitoring foreign government policies and political, social, economic, and legal conditions in countries where it has a relationship with a service provider. The guidance advises that the bank's risk assessment process take into consideration relevant country risk factors and establish sound procedures for dealing with country risk problems, including having appropriate contingency plans and exit strategies.²⁴

Third Party Providers

Many banks are looking to third-party relationships because they can offer banks a variety of legitimate and safe opportunities to improve financial performance. Through effective use of third-party relationships, banks can enhance product offerings, access superior expertise and industry best practices, devote resources to core businesses, and reduce costs.

²² Section 326 of the USA PATRIOT Act and its implementing regulations require a bank to determine whether a customer is on a list of known or suspected terrorists or terrorist organizations. However, this list has not yet been issued. See last group of Frequently Asked Questions at <http://www.fincen.gov/finalciprule.pdf>.

²³ Foreign Assets Control Regulations for the Financial Community, Department of the Treasury, May 12, 2004, available at <http://www.ustreas.gov/offices/eotffc/ofac/regulations/t11facbk.pdf>.

²⁴ See OCC Bulletin 2002-16, Bank Use of Foreign-Based Third Party Service Providers, May 15, 2002.

Nevertheless, reliance on third-party relationships can increase a bank's risk profile – sometimes significantly. Increased risk most often arises from a lack of adequate planning, oversight, and control by the bank and inferior performance or service by the third party, and may result in legal costs or loss of business.²⁵ In addition, when a product is offered in conjunction with a third party, consumers benefit from having a clear understanding of what the responsibilities of each institution are to the consumer and whether the consumer has a relationship with the bank, the third party, or both.

New Product Due Diligence

Many banks have found that engaging in new, expanded, or modified bank products or services has enabled them to expand their customer base. However, the bank's ability to effectively measure, monitor, and control the risks inherent in such products or services may be compromised, if it:

- Is overly focused on expected returns.
- Does not have a good understanding of the inherent risks.
- Has insufficient governance practices.

OCC supervisory guidance advises banks seeking to offer new products and services to oversee them through an effective risk management process that includes:

- Performing adequate due diligence prior to introducing the product.
- Developing and implementing controls to ensure risks are properly measured and controlled.²⁶
- Developing and implementing appropriate performance monitoring and review systems.

The guidance also advises bank management to have a realistic understanding of the risks and rewards of the product, and to clearly understand the rationale for offering the product.²⁷

Regulation E and Deposit Insurance

There are a number of unsettled regulatory issues involving certain stored value products, including whether they are subject to disclosures under consumer protection regulations, including Regulation E (Electronic Fund Transfers) and when deposit insurance is available.²⁸ However, some banks already provide disclosures required under Regulation E, such as notification of any changes in fees or costs and notification of error resolution procedures, simply as good business practices.²⁹

²⁵ See OCC Bulletin 2001-47, Third-Party Relationships, Office of the Comptroller of the Currency, Nov. 1, 2001.

²⁶ If a remittance recipient is able to withdraw funds at an ATM or make purchases without those transactions being reflected in the available balance on a real-time basis, the U.S.-based bank could face the possibility of overdrafts. In this case, the U.S.-based bank potentially is exposed to losses.

²⁷ See OCC Bulletin 2004-20, Risk Management of New, Expanded, or Modified Bank Products and Services, May 10, 2004.

²⁸ In April 2004, the FDIC published for comment a proposed rule addressing whether funds underlying stored value cards were “deposits” under the Federal Deposit Insurance Act and, thus, potentially eligible for deposit insurance. See 69 Fed. Reg. 20558 (April 16, 2004). In September 2004, the Federal Reserve Board published for comment proposed amendments to Regulation E. See <http://www.federalreserve.gov/BoardDocs/Press/bcreg/2004/20040913/default.htm>.

²⁹ See Advisory Letter 2004-6, Payroll Card Systems, Office of the Comptroller of the Currency, May 6, 2004.

The products surveyed for this *Insights* varied as to whether they would be covered by deposit insurance. The banks interviewed differed widely on when funds were moved out of a customer's bank account in the U.S., how funds are held in transfer accounts, and when funds are transmitted to Mexico. These are all important factors in determining whether funds would have deposit insurance. Thus, banks should carefully review products before their introduction to determine if Regulation E requirements are triggered or deposit insurance is available.

Community Reinvestment Act

The OCC and other financial institution regulatory agencies have interpreted the Community Reinvestment Act (CRA) regulations to permit favorable consideration of remittance services in a financial institution's CRA evaluation as a retail service. The agencies have recognized that remittance products can provide an important service in low- and moderate-income communities, and can help financial institutions to access or expand a customer base that may not have used traditional banking services in the past. In addition to being a retail service under the regulation, remittances services may also qualify as a community development service if they increase access to financial services by low- and moderate-income persons (for example, by being offered with a low-cost account).³⁰

In a CRA evaluation, examiners consider both the extent to which a bank provides community development services and the responsiveness of the services to the needs of the community. In addition, the effect of a particular service on a financial institution's CRA rating will depend on the institution's overall performance.

V. Who Is in the Remittances Business Today?

As the cost of technology and transmitting funds abroad has fallen, competition within the remittance industry has increased, and the structure of the industry has changed. For example, in the case of Mexico, as remittance activity has climbed rapidly, both competition and consolidation have increased, and transaction costs have fallen. In 2003, six money transmitters, together, held at least 60 percent of the remittance market to Mexico, twice as many companies as held that market share in 1999. Although more firms have entered the business, consolidation has also occurred, as some of the larger firms acquired smaller competitors.

Joint arrangements between U.S. banks and Mexican banks have reduced the internal costs of bank-to-bank transfers and have given U.S. banks a dedicated distribution channel. A number of relationships are the result of U.S. banking companies obtaining an ownership stake in Mexican banks. In addition, some U.S. banks have developed joint arrangements with Mexican banks without acquiring interests in those institutions.

At least 60 U.S.-based depository institutions offer some type of remittance product to Mexico, most with the goal of establishing deeper customer relationships with remittance senders.³¹ These institutions include both large banks that have established joint arrangements with Mexican banks, and small banks that provide additional ATM cards, and credit unions.

The Mexican government has helped create a network of small banks called *La Red de la Gente* (the People's Network) led by *Banco del Ahorro Nacional y Servicios Financieros* (National Bank of Financial Services) or "Bansefi." This network of small savings banks has a greater presence in rural areas than do the traditional banks, but these banks do not offer any loan products. At least one bank in the U.S. has developed a relationship with this network to serve as a low-cost distribution agent for its money transfer product.

³⁰ See interagency letter regarding consideration of international remittances services in a CRA evaluation at <http://www.ffiec.gov/cra/pdf/060304remittances.pdf>

³¹ Manuel Orozco, "The Remittance Marketplace: Prices, Policy and Financial Institutions," Pew Hispanic Center, June 2004, pp. 3-4.

VI. How Does the Cost Structure Work?

The cost to consumers of remitting funds typically depends on the:

- Foreign exchange rate that the provider offers.
- Fee(s) that the provider charges.

Table 1 on page 3 shows the charges for various remittance methods.

How exchange rates are set varies from country to country. Some nations establish an official rate, others have an official rate that is designed to allow some deviation from the rate, and still others allow the exchange rate to float as the market determines. There are also variations on each of these general models. For Mexico, the market sets an interbank exchange rate, with the central bank able to influence the exchange rate both through its ability to auction U.S. dollars and its ability to affect interest rates.

The interbank rate is the rate that banks use to settle their accounts with each other. Banks then add a spread, or premium, to the interbank rate to come up with a rate offered to the public. This spread is intended both to earn income for the bank and to protect it from swings in the market before accounts are settled at the end of the day. As of June 2004, spreads that banks charge for remittances to Mexico range from 0.5 percent to 1.5 percent.

The total cost to consumers is a combination of the foreign exchange rate spread and the fee charged by the provider. As of June 2004, fees charged for remittances to Mexico generally range from 1.5 to 3.5 percent. Normally a higher exchange rate spread will imply a lower fee; therefore, the total cost for a consumer generally ranges from 3 to 4 percent.

Some banks also manage their foreign exchange risk by providing an estimated exchange rate, for informational purposes, when funds are moved from an account to a transfer product, but then actually using the exchange rate that applies when the funds are withdrawn in Mexico.

Concerns have been expressed that it is difficult for consumers to compare the full cost of the wide range of remittance products on the market. One firm may offer a better exchange rate, but may charge a higher fee to the sender. In addition, the recipient in Mexico may face fees, depending on the distribution channel. To the extent that consumers could easily obtain full information on all costs related to each product, it would increase pricing transparency and enable consumers to more accurately compare costs of the various products.

Federal Reserve ACH Mexico Service

In February 2004, the Federal Reserve banks opened their Mexico Service to all banks. The service currently supports processing of credits originated in U.S. dollars and destined for bank accounts in Mexico. Transactions are originated in a fixed amount of U.S. dollars, converted by the Mexican central bank into a variable amount of Mexican pesos, and credited to the receiver.

The inclusion of foreign exchange in the service provided by the central banks can help banks of any size offer as many transfers as needed. Otherwise, banks that do not have large enough volumes to offer their own foreign exchange must work with a foreign exchange provider, such as a bank with an international presence. The Mexico Service also provides other efficiencies for participating banks. For example, cross-border items can be commingled with domestic ACH payments using standard connections and formats.³²

³² Elizabeth McQuerry and Jennifer Grier, "FedACH International Services Opens Payments Channel to Mexico," *Partners In Community and Economic Development*, Federal Reserve Bank of Atlanta, Vol. 14, No. 1, 2004, p. 4.

VII. What Barriers Have Constrained the Growth of Bank Remittance Products?

The question remains – if remittance products offered by banks provide greater value to consumers than competing products, why have banks captured less than 10 percent of the remittance market to Mexico? According to the bankers and industry observers interviewed, a few key factors have restricted product growth.

Loyalty to current provider. Money transmitters developed this product and know their customer base. Banks are relatively recent entrants to this product, as traditional bank wire transfer products were not designed for sending relatively small amounts of money frequently. Many consumers are reluctant to change habits if they already use a product that meets their needs and is reliable. In general, many new immigrants rely upon the word-of-mouth knowledge and experiences of more established immigrants to learn how to function in the United States. For example, if new arrivals are typically advised by immigrants already here to use a money transmitter, the reliance on money transmitters is likely to continue.

Consumers who use these products often develop an intense loyalty to the individual store agents for the money transmitters. In these stores, they often deal with the same person each time they send or receive money. Banks face the difficulty of trying to move people to products that offer long-term benefits to a consumer, but which may reduce the amount of personal contact a consumer has with a service provider. If consumers value personal contact more than low prices, this barrier becomes significant.

Immigrants from Latin America may have little experience with banks in their own country. From their home country experiences, blue-collar immigrants may perceive banks as unwelcoming institutions, used only by the wealthy. In addition, if major banking scandals or failures have occurred in their home countries, the money transmitters may be viewed as a more secure method of sending money home. Marketing a bank product in a manner that addresses consumers with limited knowledge of financial products is a crucial step for a bank product to gain acceptance.

Money transmitters are ubiquitous and convenient. The major money transmitters can leverage their distribution capabilities to make their names synonymous with remittances. Each of the two largest companies has more than 100,000 locations worldwide where their products are available. In 2003, an estimated 40 million remittance transactions carried money from the United States to Mexico, but together, the four largest banks in this field in the U.S. conducted less than 100,000 remittance transactions per month.³³

Money transmitter services are available at a wide range of locations that immigrants patronize regularly, including corner grocery stores, major chain supermarkets, and check cashers who may offer a variety of financial services typically used by unbanked consumers. These locations typically are open for longer hours during the week than banks, and on weekends. Some customers may be more comfortable with the quicker process and minimal paperwork offered by these services. Banks also may have customer identification procedures that some persons prefer to avoid.

This infrastructure differential between banks and money transmitters both here and abroad may well be the largest hurdle for banks seeking to expand their role in the remittance business. There are certainly fewer bank locations in the U.S. where a remitter can have personal contact with the institution than there are money transfer businesses. As a result, some banks have developed partnerships with at least one of the major money transmitters, so that the money transmitter's products are available at bank branches in the U.S.

³³ Manuel Orozco, "The Remittance Marketplace: Prices, Policy and Financial Institutions," Pew Hispanic Center, June 2004, p. 2.

Access to banks in Mexico and comfort with bank products is limited. Banks and ATMs, while present in urban areas in Mexico, are virtually nonexistent in many rural areas. Mexican immigrants are less likely to use banks when remitting money to rural areas where banks do not have a presence.³⁴ Even in rural areas where small savings banks or credit unions have a presence, they are unlikely to have an ATM, thereby preventing electronic access to funds by recipients. Further, the lack of familiarity and comfort with bank products, especially in rural areas, presents a related challenge to banks that are trying to introduce a new remittance product.

A lack of comfort with English can make immigrants reluctant to use banks. Immigrants are unlikely to enter a bank branch if its physical appearance is intimidating and few bank employees speak Spanish, or if the immigrants are not aware that they can communicate with bank employees in Spanish. As bank products are more complex, with linked primary accounts and more extensive documentation and disclosures that may be difficult to understand, banks must find ways to persuade consumers that the lower cost of the products and the potential to participate in the American banking system outweigh the inconveniences and discomfort of learning about new products. Therefore, some banks have arranged for a significant number of bilingual staff to be available in branches where many customers prefer to speak in Spanish, while others are committed to ensuring that at least one bilingual staff member is present in every branch. Some banks also offer Spanish product literature, Web site capability, and financial literacy materials.

Minimum deposit requirements and fees raise costs. A number of bank products depend on consumers opening a bank account. However, many remittance senders may not have enough money to meet the minimum deposit requirement. Further, minimum deposit requirements may impose fees that conflict with how remitters would tend to use accounts – make deposits, build up a certain amount, and then send it all to their home country.

VIII. Conclusion

As a result of the rapidly growing U.S. Hispanic population, banks are developing new products and services to meet the needs of this market. Many bankers and industry observers have commented that the fastest growing area for bank products and services is the ethnic market, especially among Hispanics. As this *Insights* recounts, a number of banks have developed low-cost remittance products in the hope of capturing some of the unbanked population in the U.S., with an eye on then deepening relationships with these consumers.

However, banks are finding that consumers who remit funds abroad have become comfortable with, and loyal to, their current providers. Thus, to penetrate this market further, banks will need to continue to communicate the benefits of having a relationship with a bank. Banks must also balance the cost savings of electronic transmission and delivery of funds with an expectation of personal service by consumers likely to be new to bank products.

For banks to become leading providers of remittances to Mexico, the percentage of Mexicans with bank accounts must increase, and banks must develop a means of allowing consumers to access their products in rural regions of Mexico. Electronic delivery is the strength of bank distribution of funds, and its benefits are maximized when remittance recipients hold accounts in which funds can be electronically deposited and accessed. A related question is how quickly card-based payment methods will be accepted in Mexico by both consumers and merchants. The cost

³⁴ Catalina Amuedo-Dorantes and Susan Pozo “On the Use of Differing Money Transmission Methods by Mexican Immigrants,” mimeo, 2002 referenced in Robin Newberger et al., *Immigrant Financial Market Participation*, Chicago Fed Letter, Number 199, February 2004, p.3.

of remittances could be further reduced if remittance recipients use debit cards and could access funds either at an ATM or by making purchases. However, these products also present risks that banks need to be aware of, monitor, and act upon.

As the product matures, banks will likely evaluate its effectiveness in attracting new customers and whether these customers will be receptive to the cross-selling of a variety of consumer banking products. Thus, the market for remittances to Mexico is likely to remain competitive, with both banks and their competitors vying to meet the needs of remittance senders.

Additional Resources

Multilateral Investment Fund of the Inter-American Development Bank

Knowledge Sharing

List of Conferences and Publications on Remittances

<http://www.iadb.org/mif/v2/remitCONF.html>

Inter-American Dialogue

Various publications on Remittances

<http://www.thedialogue.org>

The World Bank

Workers' Remittances: An Important and Stable Source of External Development Finance

http://www.worldbank.org/prospects/gdf2003/gdf_ch07_web.pdf

Pew Hispanic Center

Various publications on Remittances

<http://www.pewhispanic.org>

International Monetary Fund

Country information

<http://www.imf.org/external/country/MEX/index.htm>

Glossary

automated clearing house (ACH) An electronic clearing and settlement facility for interchange of electronic debits and credits among financial institutions. ACH systems process large volumes of payments electronically. Traditional ACH payments include direct deposit of salaries, consumer and corporate bill payments, interest and dividend payments, and Social Security payments.

automated teller machine (ATM) A computer terminal, usually activated by a magnetically encoded card, allowing consumers to make deposits, obtain cash, pay bills, transfer money between accounts, complete other routine transactions as they would at a bank teller window.

branded card A bank-issued card that has a national brand (Visa or MasterCard) on it.

debit card A plastic card giving customers access to their funds electronically. Debit cards act like checks and can be used when paying for goods and services or withdrawing cash at automated teller machines. Debit cards with MasterCard or Visa logos are often accepted in retail establishments that will not accept checks. Consumer purchases with a debit card, unlike a credit card, do not offer the convenience of paying over time, because funds are withdrawn immediately (date of purchase with on-line transactions, generally within two days for off-line transactions).

direct deposit Automatic deposit of wages or benefits (such as Social Security payments) into a consumer's bank account.

interbank transfer An electronic transfer of funds through an account balance at the Federal Reserve or an account balance at a correspondent bank.

matricula consular Identification card issued by Mexican consulates for Mexican nationals living abroad. Requires proof of Mexican nationality and proof of current address.

money services business (MSB) Any person (an individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, an Indian Tribe, and all entities cognizable as legal personalities) doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities:

1. Currency dealer or exchanger.
2. Check casher.
3. Issuer of traveler's checks, money orders, or stored value.
4. Seller or redeemer of traveler's checks, money orders, or stored value.
5. Money transmitter.
6. U.S. Postal Service.

The term "money services business" does not include a bank, as defined in 31 CFR 103.11(c), or a person registered with, and regulated or examined by, the Securities and Exchange Commission or the Commodity Futures Trading Commission. For the complete regulatory definition of "money services business", see 31 CFR 103.11(uu).

personal identification number (PIN) Numeric identification code used by bank customers when making transactions at a banking terminal, such as an ATM, or over the telephone.

point of sale (POS) terminal A device placed in a merchant location that is connected to a payment processor by telephone lines and is designed to electronically authorize, record, and forward payment for each sale as it occurs.

pre-paid debit card A debit card on which funds are loaded and drawn down through purchases or cash withdrawals. Additional funds may or may not be loaded onto the card. Prepaid and stored value cards are the same.

Regulation E Federal Reserve regulation that sets rules, liabilities, and procedures for electronic funds transfers (EFT), and establishes consumer protections using EFT systems. This regulation prescribes rules for solicitation and issuance of EFT access devices, governs consumer liability for unauthorized transfers, and requires financial institutions to disclose annually error resolution procedures.

stored value card *See* prepaid debit card.

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