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Remittances and the unbanked

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On November 9, 2001, the Federal Reserve Bank of Chicago and Global Chicago[1] hosted a symposium on consumer international money transfers or "remittances." These are transfers of funds by individuals in the U.S. to people in other countries. The symposium addressed the human aspects of money transfers, the technicalities of the process, the methods and importance of monitoring financial transactions, and ways to improve the money transfer process. Many people who use international money transfers are in the "unbanked" category, meaning they do not have bank accounts, and much attention was placed on money transfers as a way of integrating the unbanked into the mainstream financial system.[2]

The human aspect

Curt Hunter, director of economic research at the Federal Reserve Bank of Chicago, emphasized in his introductory remarks the important role remittances play in the U.S. economy and in many foreign economies. He noted that remittances from the U.S. are estimated to have been as high as $20 billion in 2000, not including unofficial transfers. Mexico received the bulk of U.S. remittances in 2000, worth $6.3 billion. With a growing population of Mexican immigrants, Chicago is a significant source of remittances.

Hunter argued in favor of making international transfers cheaper, noting that, in many cases, the total cost of a remittance is 10% to 20% of the value of the transaction. He summarized the role of remittances in the financial system as follows: "We like to think of remittances not as an end in itself, but as a possible vehicle that can help bring the low-income portion of recent immigrants into the financial mainstream."

Next, Manuel Orozco, project director for Central America, Inter American Dialogue, discussed emigration and the importance of remittances to many Latin American communities. In most Latin American countries, there has been a shift away from agricultural production, causing many former agricultural workers to migrate to the U.S. in hopes of finding work. Families and communities left behind often experience disruption to their social fabric and livelihood.

In the past 20 years remittances to Latin American countries have increased not only in volume, but also as a share of national income and total exports. Remittances are another way in which countries are becoming globally interconnected. Orozco also discussed the high cost of remitting. He noted that the recent proliferation of companies that handle international money transfers has led to a gradual decline in transfer costs due to competition among providers. Remittances are usually sent either through transfer services, such as Western Union, or banks, which are viewed less favorably by low-income immigrants, especially illegal immigrants. In many countries, state-sponsored programs, such as investment matching programs, create an incentive to invest in the sender's home country. Furthermore, invested remittances may reduce the need for future generations to emigrate.

Next, Louis DeSipio from the University of Illinois examined remittances from the perspective of the sender. According to various surveys, 60% of Latino immigrants sent money home in the past year and 40% remit regularly. Most households that remit are low-income and send between $2,500 and $3,000 a year, an amount that increases less than proportionally with household income. Immigrants are more likely to save than to remit, although some of the money saved may eventually be brought back to the home country in person.

Immigrants who remit tend to be young and poorly educated. They are neither permanent residents nor U.S. citizens and they tend to have immediate family in the home country. Among Latinos, Central Americans are the most likely to send money home. Remitted funds go mainly toward household expenses, especially health care. Investments make up a small share of the funds remitted. Among immigrants who are saving money and plan on returning to the home country, over 45% plan on investing some of their savings.

Una Osili from Indiana University looked at the issue of remittances from a different angle: impact on the home country. Using original research, Osili discussed remittances to Nigeria, where their value is equivalent to 10% of exports. Remittances to Nigeria are about 12% of the sender's household income and tend to continue over a long period. Remittances play an important role in reducing poverty and income inequality and can affect a wide range of economic decisions.

Osili identified three types of remittances: home family transfers, which fund the purchase of durable goods, emigrants' savings in the home country, which finance investments, and community-based transfers, which finance development projects. For Nigeria, Osili found that the majority of remittances are sent through informal channels. There are benefits to informal transfers, such as the reduced cost of fees for sending the money and favorable exchange rates, but there are also disadvantages, such as the risk of losing the money, a reliance on informal contracts, and search costs for finding someone to take the money abroad.

Oscar Chacon from the Heartland Alliance outlined the channels by which immigrants send remittances. He pointed out that illegal immigrants may have difficulty sending remittances through any institution that asks for a Social Security number or tax identification number. Meanwhile, recipients of remittances, especially in Latin America, are often reluctant to deal with banks. Many Latin American banks deal mostly with corporate clients and do not have a reputation for accessible banking for individuals. Furthermore, the banking system in Latin America is often regarded as corrupt, creating a disincentive for individuals to form relationships with banks. Chacon speculated that remittances may ultimately reduce emigration to the U.S., and asked whether we should legalize some currently illegal forms of immigration.

German Zarate from State University of New York, Cortland and El Colegio de la Frontera Norte (COLEF) discussed remittances to Mexico, the destination of $6.3 billion in U.S. remittances in 2000. He identified four known sources of remittances: permanent emigrants, whose primary residence is in the U.S.; temporary emigrants, whose primary residence is in Mexico; in-kind transfers; and hometown associations. Two other sources Zarate mentioned as potentially important are Social Security payments and commuter migrants. Permanent emigrants have higher average incomes than temporary emigrants, but they send less money home per emigrant. Electronic transfers now account for more than half of the total official remittances sent to Mexico. Recipients of remittances are increasingly likely to live in rural areas and remittances are concentrated in specific, and often rural, areas of the country. Zarate also noted that hometown associations have become increasingly common in the U.S. These associations help immigrants to pool their resources for larger projects, such as developing a better public infrastructure in their hometowns in Mexico.

The money transfer process

The second conference panel addressed the technicalities of money transfers. Dan Nemec from Citicorp Electronic Financial Services discussed the electronic benefits transfer (EBT) card, an electronic system that allows a recipient to authorize transfer of their government benefits from a federal account to a retail account. Another initiative designed for underserved markets is the expansion of retail debit card services. These would include payroll products for unbanked employees, access cards for customers of check cashing services, global wire cards, and multi-functional college ID cards. Nemec noted that, in general, money transfer users do not like banks, do not like to divulge information, and are loyal to reliable service providers. The challenge for the banking community is to find practical solutions that address these consumer characteristics.

One of these practical solutions is a two-card electronic deposit account (EDA). An immigrant would open a recurring deposit account in the U.S. and would receive two ATM cards to access the account. One of these cards could be used by family members in the country of origin to make withdrawals from the account. The amounts and frequency of these withdrawals could be restricted by the primary cardholder. A single-issue global wire account would work on the same principles but could only be used for a single deposit.

Banks face some important challenges, in terms of regulation, ambiguity of the Know Your Customer provisions[3] (particularly with respect to Social Security numbers), increasing available distribution outlets and access endpoints, and enhancing customer outreach. However, money transfers could be the starting point for familiarizing customers with mainstream banking products, thereby allowing banks to tap into a new customer base. International money transfers also help banks build brand loyalty with an emerging middle class, giving them the opportunity to sell other products to these consumers.

Next, Salo Eduardo Levy from Western Union explained that, historically, international money transfers were exclusively telephone transfers but are now almost fully driven by computer technology. Consumers can go to any one of the nearly 40,000 Western Union agent locations in the U.S. and fill out the required forms. A clerk then enters the send instructions into a computer that is linked to the central office, with 92% of agent locations being PC-based. The clerk collects the amount of money the sender wants to send, plus the amount of the service fee in cash. In the case of a transfer to Mexico, for example, the transaction receipt shows the total amount paid, the amount of the service fee, the currency exchange rate, and the total amount of pesos that will be paid out at any of the nearly 6,300 agent locations in Mexico. The sender advises the recipient that the money is available for pick up at any of the agent locations, where the recipient picks up the amount of pesos sent in cash, without paying any additional fees.

Levy also noted that almost 40% of Western Union agent locations in the U.S. are in supermarkets and around 20% offer check cashing services. In Mexico, payout locations include retail stores, banks, and telecommunication services with extensive geographic coverage. The location of agents is critical and Western Union has consciously made efforts to set up agents in places that are easily accessible to the immigrant community.

Also on the theme of making services more accessible to immigrants, Ernst Heldring from Harris Bank/Bank of Montreal discussed the bank's effort to reach out to the Hispanic community in Chicago, with 24 branches now designated as "bilingual branches." With its affiliate in Mexico, Bancomer, Harris Bank now offers a competitive electronic fund transfer service to Mexico without intermediaries. Three important issues Heldring raised were costs, regulation, and education. High front-end system costs are a deterrent for other players to enter the market, creating an oligopoly for those already in the market. In addition, post September 11, regulatory issues are likely to be of greater concern for players in the international money transfer market. Finally, Heldring emphasized the challenge of educating the unbanked to use banks and new technologies.

Role of government and regulatory agencies

Juan Hernandez, director of Mexico's Office of the President for Mexicans Abroad, discussed his government's efforts to lower the cost of wire transfers. Remittances are Mexico's third largest source of foreign income. Temporary workers in the U.S. send 40% to 60% of their monthly income home, while more permanent workers send around 15%. Money transfers play a crucial role in the daily lives of families of migrant workers, and some families rely almost exclusively on remittances for their survival.

Only 10% of Mexicans have bank accounts and many Mexicans are distrustful of banks. In addition to making money transfers safer and easier, integrating migrants into the banking system could lower the cost of remitting, because exchange rates for money transfers are generally more favorable at banks than through transfer services or money exchanges. Hernandez pointed out that, although legal immigrants need to be informed about banking, it is the undocumented immigrants who send the most money home. Undocumented immigrants usually cannot open bank accounts because they lack tax identification numbers or Social Security numbers. In conclusion, Hernandez emphasized the benefits of investing in the home community for both the U.S. and Mexico, noting that such investment (funded by remittances) creates jobs for future generations, thereby reducing their need to emigrate to the U.S. to find work.

The next group of speakers examined some of the regulatory issues that underlie any debate on international money transfers, including how the events of September 11 have affected regulation in this area. Jack Wixted of the Federal Reserve Bank of Chicago's Department of Supervision and Regulation discussed the recently passed Money Laundering Act,[4] which strengthens the Know Your Customer requirements. The act increases the amount of information banks may be required to obtain and the minimum standards for customer identification at account opening. Clearly, these requirements could make international money transfers more difficult, especially for undocumented immigrants. Banks may be required to compare clients' names with a list of known terrorists maintained by the U.S. government. There are many common names on the list and concerns have been raised about incorrect matches. Bankers are also uncertain of how they would be expected to respond if a customer's name matched one on the list and how they would go about verifying the customer's identity.

New ideas, new technologies

The final session of the symposium explored some of the new ideas and technologies for sending international money transfers. George Franco, chairman and chief executive officer of National Financial Corporation and chairman of the nonprofit Council on Financial Access in the New Economy, expressed optimism about the future of consumer money transfer and money transfer alternatives. The current technology for money transfers is PC-based rather than mainframe- or paper-based, making it far more efficient and lowering the cost.

As this market continues to grow, institutions that include large banks will find the market attractive due to its new revenue opportunities and relatively low risk. Technology is already available that enables financial institutions to efficiently process both originator and beneficiary transactions for immediate payment to the customer, while effectively monitoring transactions for compliance purposes on an automated basis. This includes compliance regulations related to the Bank Secrecy Act, the Office of Foreign Assets Control, as well as Know Your Customer regulations.

For banks and other service providers that successfully reach this market, these customers represent a significant business opportunity for other bank products and services. Institutions that fail to reach these high-growth markets risk being left behind.

Pedro de Vasconcelos from the Multilateral Investment Fund (MIF) of the Inter American Development Bank (IADB) pointed out that remittance flows to Latin America and the Caribbean are substantially higher than the total of official development assistance to the region. The IADB supports increasing the level of remittances to underdeveloped countries by reducing the cost of transfers. The MIF is trying to identify ways of stimulating the impact of remittances by increasing

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competition among providers of money transfer services and promoting the use of formal financial systems, thereby decreasing the cost of sending remittances. Channeling capital into investment is another method of increasing the impact of remittances. Some of these strategies are already being used, including a program that links Ecuadorian financial institutions and Spanish credit unions to try to reduce the cost of sending remittances between the two countries.

David Grace from the World Council of Credit Unions discussed the role credit unions play in providing emigrants with inexpensive and efficient means of sending remittances. Credit unions are not-for-profit organizations and typically serve low-income groups. They often work with individuals who are underserved by mainstream financial institutions. One of the challenges Grace identified was educating banks and credit unions on the requirements for sending an international money transfer. Contrary to widespread beliefs and practice, banks do not need a Social Security number or tax identification number in order to open an individual bank account—as long as it is not an interest-bearing account.

Grace also pointed out that if a goal of policymakers is for the unbanked to have access to mainstream financial institutions, their strategy should not be to lower costs at transfer service companies but rather to encourage greater outreach by financial institutions such as banks and credit unions.

Conclusion

Technological advancements in payments mechanisms are bringing down the costs of money transfers. In addition, new market entrants and greater competition are contributing to lower costs. However, as in other markets, consumers are reluctant to change products, and it is often more difficult for new products to penetrate the market when new technologies must be learned. As a result, significant marketing and financial literacy efforts are needed to introduce emerging remittance vehicles to low-income immigrants. Organized assistance and collaborative efforts between financial institutions and community groups may also be helpful in bringing immigrants into the financial mainstream, as would a less stringent interpretation of regulations that appear to inhibit immigrants from opening bank accounts.

[1]Global Chicago is a collaborative project devoted to enhancing Chicago's global strengths and raising awareness of the metropolitan area's global connections.

[2]The authors would like to thank Farzad Damania for his assistance. Biographies of the panelists and copies of their presentations are available at www.chicagofed.org/unbanked/conferences/index.cfm.

[3]Know Your Customer guidelines are contained in Section 600 of the Bank Secrecy Act and are intended to assist financial institutions in creating policies that will detect suspicious activity by customers. There are no existing regulations for the Know Your Customer guidelines, but recently passed anti-terrorism legislation makes future regulations likely.

[4]The International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 is Title III of H.R. 3162, the USA Patriot Act, passed on October 26, 2001. Title III includes provisions to facilitate the prevention, detection, and prosecution of international money laundering. For more details, see Board of Governors of the Federal Reserve System, 2001, "Supervision and Regulation letter," Division of Banking Supervision and Regulation, No. 01-29, November 26.