

P E R S P E C T I V E

International Remittances



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“Remittance is the act of transmitting money to a distant location to fulfill an obligation”

This Knowledge Paper makes an effort to elucidate the concept of remittances in the international context and is focused on the remittances sent by emigrants to their families back home, for domestic consumption and investment. The paper highlights the significance of International Remittances to the global economy, details existing business models, and examines emerging trends as well as challenges faced by an industry which is poised to play a bigger role in the globalization process.

Remittances Overview

In this globalizing world, migration of people from one country to another for employment opportunities has become a common phenomenon. Dominant migration corridors have been formed between various countries/regions. This is primarily due to the socio-economic conditions prevailing in the migrants' countries of origin and destination. A few examples:

Migrant-sending country:

- Lack of job opportunity
- Lower wage rates
- Social insecurity
- Political instability
- Extreme geographical conditions

Migrant-receiving country:

- Availability of employment
- Friendly migration policies
- Shortage of skilled resources
- Financial liberalization
- Abundance of natural resources

A few examples of such corridors (sender country-receiving country) are **Mexico-US**, **South Asia-UAE** and **India-US**.

Impact on Global Economy

This section highlights the magnitude and impact of increased migration on the world economy.

The World Bank estimates that remittances in 2009 totaled \$420 billion - out of which \$317 billion went to developing countries - and involved some 192 million migrants or 3.0% of the world population.

Figures 1 and 2 respectively depict the remittances of top remittance sending and receiving countries for 3 consecutive years.

Figure 3 expresses the quantum of this incoming money as a percentage of GDP thereby indicating its significance to the destination country's overall development. (Source: World Bank website)

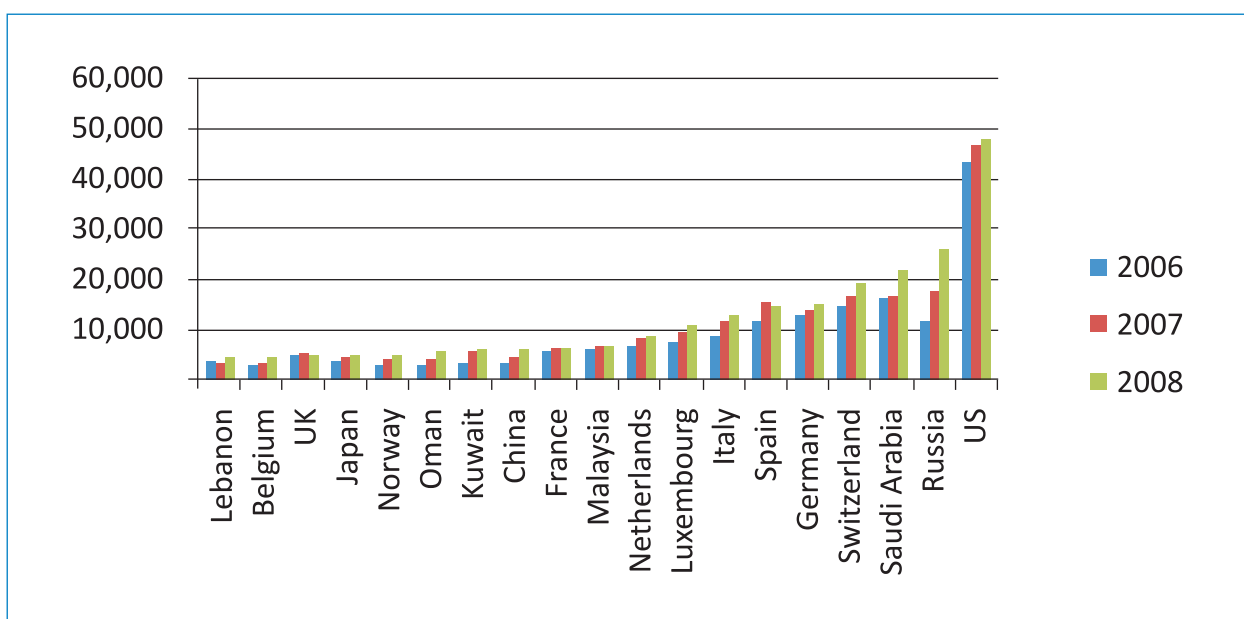


Figure 1 Top Remittance-Sending Countries (figures in US \$ million)

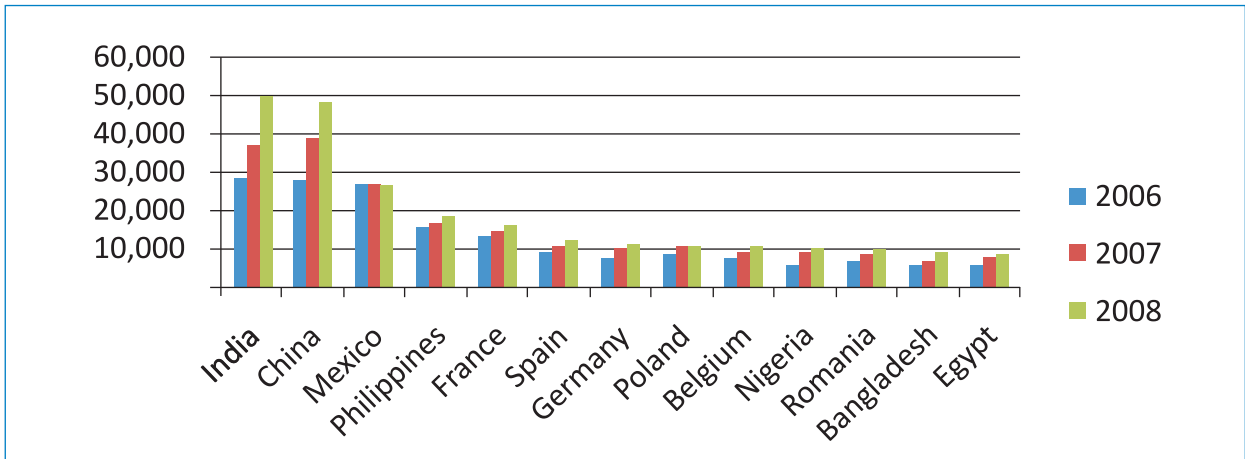


Figure 2 Top Remittance-Receiving Countries (figures in US \$ million)

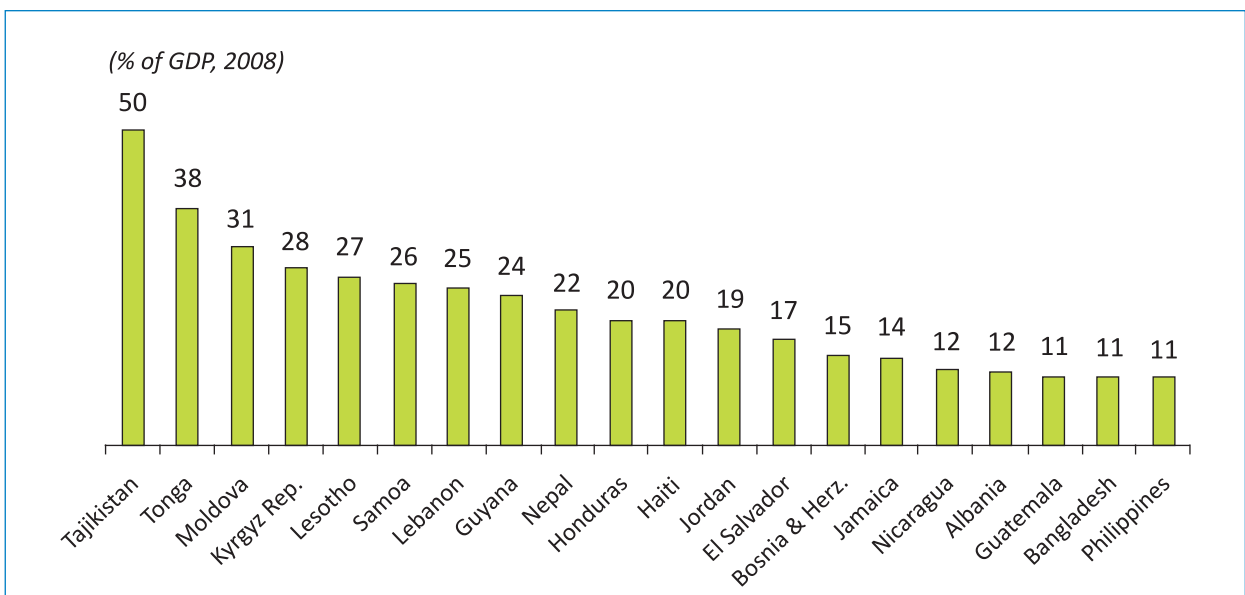


Figure 3 Remittances as a Percentage of GDP

Operating Models in the Remittance Business

An International Remittance business may follow the conventional banking model or any of the non-banking models.

Conventional Banking Model

In this model, an end-to-end remittance transaction involves the following parties:

- **Remitter's Bank** - the bank where the remitter has an account that is debited for transferring money to the beneficiary
- **Beneficiary's Bank** - the bank where the beneficiary of the remittance has an account that is credited for the remittance money received
- **Correspondent Bank** (only in cases where the above-mentioned entities do not have a direct business tie-up) - an intermediary bank which has associated with various

banks globally, through which remittance transactions are routed

Figure 4 illustrates the **Nostro-based** setup, wherein the Beneficiary Bank has an account with the Correspondent Bank, while Figure 5 shows the generic process involved in a remittance transaction based on a Nostro account model.

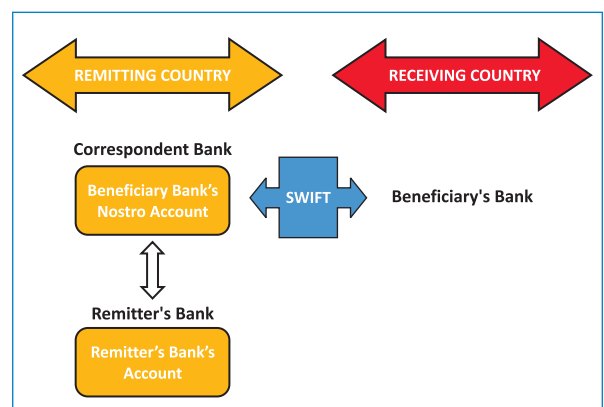


Figure 4 Nostro-based setup

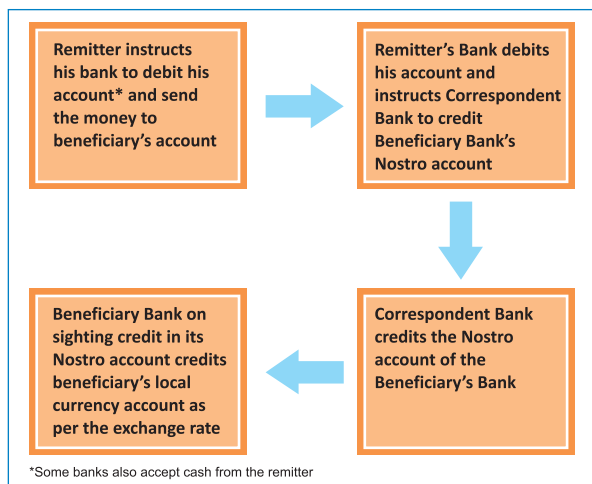


Figure 5 Remittance Transaction Process in a Nostro-based Setup

Modes of Remittance

There are various **Origination Modes**, which are used by the remitter to transfer money.

The remitter can issue a remittance request to his bank either

- by visiting the **branch** and furnishing a *Remittance Instruction Form* prescribed by the Remitting Bank, bearing all details necessary for effecting the remittance along with an account debit mandate
- or
- by dropping a **cheque** from an account with the Remitting Bank along with the *Remittance Instruction Form*

Based on the details in the form, the Remitter's Bank debits his bank account and sends a SWIFT message to transfer the money to the Beneficiary's Bank.

Listed below are the various **Disbursement Modes** of remittance using which the money can be tendered to the beneficiary.

- Direct Credit** to the beneficiary's account with the Beneficiary Bank
- Disbursement of Cash** to the beneficiary on furnishing appropriate photo - identification/ address proof in the event of his not having a bank account
- Transfer of Money** by the Beneficiary Bank to the beneficiary's account with some **other local bank** using the local payment mechanism
- DD** issuance in the name of the beneficiary

Non-Banking Channels

Non-banking players play a vital role in the remittance space and have a larger share in the Global Remittance business than conventional banks. These entities operate in various forms:

Money Transfer Operators

MTOs (Money transfer Operators) like Western Union and Money Gram have a network of agents across the globe and serve as non-bank remittance channels.

The remitter can visit an MTO outlet and pay cash in foreign currency to send money to any part of the globe where the MTO's agent is present. The receiver can visit the MTO agent at his location and collect the money in local currency.

Figure 6 depicts the process for an International Remittance transaction effected through an MTO.

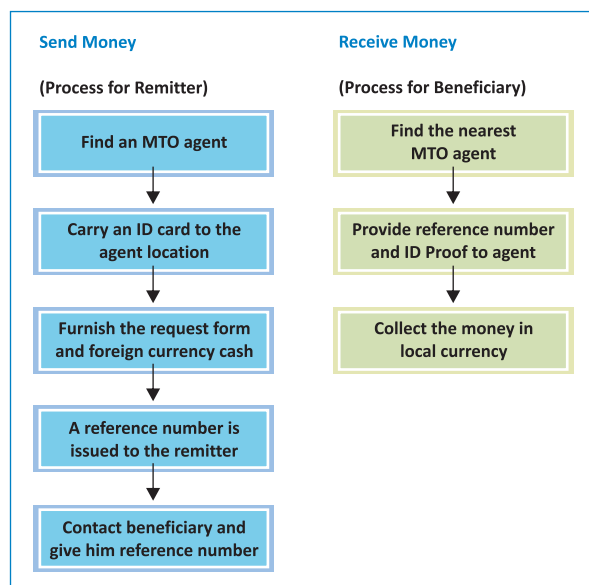


Figure 6

The settlement between the MTOs in the two countries takes place through their partner banks. On receiving the remittance amount in cash from the remitter, MTOs deposit those funds in their local bank accounts. MTOs request their bank to transfer the consolidated amount to the bank account of the MTO agent in the receiving country. In order to minimize costs, only the net amount (total amount to be sent to the recipient country minus total amount to be received from that country) is sent.

Please note that the beneficiary receives the money much before the settlement between the MTOs

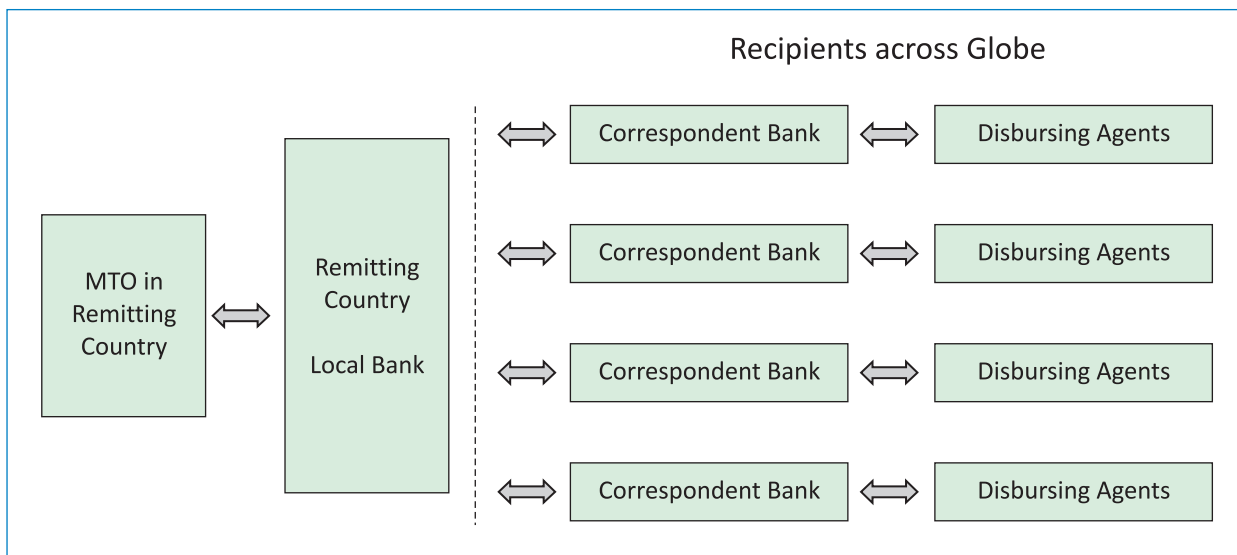


Figure 7 Fund Movement for an MTO

Costs

The fixed costs incurred by an MTO are listed below:

1. Origination and Disbursement Agent Network Costs

Setting up agency networks/outlets in the country of origination and disbursement forms a significant portion of an MTO's costs. Though traditionally, MTOs have had proprietary agents, of late, third party agents have also been appointed by Western Union and Money Gram. While these agents receive a fixed minimum compensation, major incentives are linked to the number and value of transactions. The MTOs thus share the risk of expanding their network with these partners.

2. Processing and Money Transfer Costs

These are the fees to be paid to the local bank which buys and sells various international currencies, on behalf of the remittance service provider. These costs are linked to the aggregate transaction value and MTOs with large volume transactions could negotiate lower fees.

3. Marketing Costs

This simple transaction processing business has now become commoditized and players

have started spending on advertising and brand building.

4. Compliance and Regulatory Costs

Various mandatory compliance/regulatory procedures in the remittance business are listed below. Expenses involved in following them form a sizeable part of the total cost.

- **KYC of Remitter / Beneficiary**

To prevent practices like transfer of money between anti-social elements, the "Know Your Customer" checks are done by the Remitter's and the Beneficiary's Bank. KYC would typically involve obtaining documents such as photo-ID, address proof, passport details, driving license details etc.

- **Regular Reporting of Transaction Details to the Central Bank**

Central Banks place limits on the value of an individual's remittances within a certain time frame.

Additionally, institutions are also supposed to comply with **Anti-Money Laundering** requirements and report any **suspicious/fraudulent** transactions to the Central Bank.

5. Administrative and IT costs

The MTO will also have to bear office maintenance expenses as well as system development and maintenance costs.

Risks

Currency Hedging

When there is an International Remittance transaction through an MTO, there is a time lag between fund availability to the recipients (money is generally received the same day) and actual international transfer by the MTO's partner bank through its Correspondent Bank (generally takes 3 business days). This implies a currency rate risk which is borne by the MTO.

Salient Features of the MTO model

1. It is the fastest mode of transfer since the beneficiary can receive the money within seconds after it is sent.
2. People without bank accounts can also transact in this model.
3. The cost per transaction is lower compared to other models.
4. MTOs have the biggest market share in the remittance business.
5. Setup costs are high, acting as a barrier for new entrants.

Exchange Houses

Exchange Houses are extensively used for remittances from the Middle East. Unlike the banking channel, this channel is based on **Vostro** accounts i.e. the accounts maintained by exchange houses with various banks in the beneficiary countries. These accounts are pre-funded by the exchange houses.

The Remittance Transaction Process

- Step 1** The remitter deposits the remittance money in the overseas currency in cash at the Exchange House counter.
- Step 2** The exchange rate and the transaction fee are communicated and confirmed over the counter.
- Step 3** The beneficiary account details are provided by the remitter.
- Step 4** The exchange house instructs the Beneficiary Bank with whom it has a tie-up for transferring the requisite amount in the beneficiary country's local currency using one of the following modes:

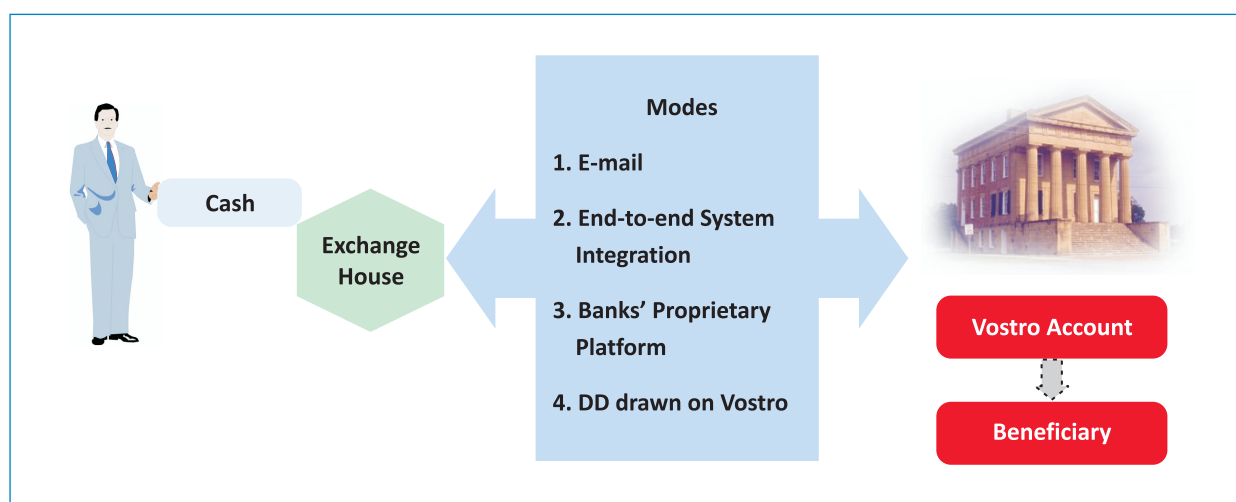


Figure 8 depicts the Vostro-based setup wherein the Correspondent Bank has an account with the Beneficiary Bank

- a. E-mail: The exchange house sends e-mail to the Beneficiary Bank instructing it to transfer the amount to the furnished beneficiary account.
- b. Integration of exchange house and Beneficiary Bank systems
- c. Beneficiary Bank's proprietary remittance platform

Costs: The costs involved are similar to that of the MTO channel.

Salient Features of the Exchange House Channel

1. Since the Vostro accounts are pre-funded, the beneficiary amount is paid based on the funding in this account. Hence, on receiving the Exchange House's

instruction, the beneficiary receives the amount almost instantaneously.

2. The Exchange House has to fund its account with the Beneficiary Bank; hence the latter enjoys the float.
3. The Exchange House can draw a DD on its Vostro account **in favor of the beneficiary** and hand it over to the remitter over the counter, which can then be dispatched by courier or even sent along with a friend travelling back home. Alternatively, the DD can also be drawn **in favor of the remitter**, who can then carry it back to his home country on his return and get it cleared there. This is a secure option for blue collar workers who would otherwise have to travel with hard cash.

Emerging Non-Banking Channels

Online Channels

Online Players, which provide platforms encompassing the entire remittance process, are a recent development. They have created global networks with banks/FIs in origination and destination countries. From the comfort of his home, the remitter can initiate a remittance request by registering himself on the online entity's website and furnishing his and the beneficiary's bank account details.

The Remittance Transaction Process

Step 1: Select the recipient country and enter the amount to be remitted

Step 2: Choose the mode in which the recipient would receive funds

- Cash pickup
- Direct deposit into bank account
- Cash delivery to the recipient's home

Step 3: Choose a payment method to confirm the money transfer

Through a card or by debiting his account with the local bank in the remitting country

Step 4: Notify the recipient about the transaction

costs

1. Creating a network of banks in the countries of origination and disbursement would be a major cost.
2. The cost involved in creating and maintaining a robust and scalable IT platform would also be significant.

Salient Features of the Online Model

1. Transaction is effected from the convenience of one's home.
2. The transaction can be effectively tracked.
3. TATs are on the higher side (3 to 5 working days).
4. The remitter has to undergo a one-time registration process which has a TAT of 4 to 5 working days.

White Label Platform Providers

A White Label Platform provider is a variant of the online platform channel, wherein a third party enables banks and FIs operating in the remittance corridors to launch remittance services by providing the following:

- A gamut of innovative products based on the latest demand, which could be further customized to meet specific requirements of banks and end customers in various geographies
- Best-in-class technology for new age business
- Marketing and sales support for promoting the product range
- 24*7 operations support in case the client proposes to outsource transaction processing
- Round the clock customer service through toll-free numbers, email support and online live chats
- Built-in international compliance and regulatory practices
- Adherence to the best practices in IT security

Costs:

1. The major cost involved is in hosting and maintaining the platform.
2. Marketing expenses form a significant part of the total cost.

Salient Features of a White Label Platform Provider

1. The provider need not be part of the banking/financial domain.
2. Without investing in technology and operations, banks and FIs can use this plug-and-play offering to provide world-class remittance services.
3. It provides all the advantages of an online platform channel to the end customer.
4. The platform provider's economies of scale reduce the per-transaction cost.

Emerging Trends in the Remittance Business

1. MTOs are leaders in the remittance space, but are being challenged by other channels.
2. The following are turning out to be **decisive factors** while choosing a remittance provider:
 - a. Transaction cost
 - b. Exchange Rates
 - c. User-friendly procedures
 - d. TAT of the transaction
 - e. Transaction tracking mechanism
 - f. Reach in the destination country
3. **Agent exclusivity**, one of the strong competitive advantages of MTOs on both the remitting and receiving side of money transfers, is eroding and agents are increasingly shifting away from the exclusivity arrangement.
4. To increase their market share, **conventional banks** are leveraging their existing client relationships and are coming up with **innovative offerings such as prepaid cards** for the beneficiary. This enables them to provide **account-to-cash** and **cash-to-cash** offerings to the customer, allowing the beneficiary to withdraw cash in tranches.
5. **SWIFT** has come up with a **Workers' Remittances** solution for banks and FIs for settlement of cross-border person-to-person payments. It aims at providing a standardized, off-the-shelf operational and technical framework to
 - a. Connect new entities

- b. Offer high-level reach and scalability
- c. Bring about efficiency in operations
- d. Ensure more consistent and faster delivery of remittance services

This system is currently being evaluated by leading banks and institutions, which provide remittance services.

6. **Online offerings** on the originating side are expected to increase in importance, in line with the growing education levels and computer proficiency of immigrants.
7. **Increasing Role of Software and Analytical Tools**

In addition to SWIFT and the local payments system in destination countries, which form the IT backbone for the remittance business, in-house systems are also being used to streamline various processing stages involved in a remittance transaction. Also, several CRM and web analytics software are being used by the service providers to analyze the transaction data for the following purposes:

- a. Understanding customer behavior
- b. Understanding business cycles
- c. Segmenting customers
- d. Launching products targeted at specific customer segments
- e. Designing marketing campaigns and incentive schemes for specific customer segments
- f. Aligning sales force and customer support channels for better customer service
- g. Effective customer due diligence through
 - i. Transaction monitoring
 - ii. Customer screening against published black lists
 - iii. Identification of risks and suspicious transactions
8. **Role of Central Banks in Recipient Countries**

Central Banks in recipient countries are playing the role of facilitator and promoter

to extract maximum benefit from the opportunities provided by International Remittances. They are:

- a. Allowing migrant workers to open **foreign currency accounts** so that
 - their earnings could be retained in foreign currency and can be exempted from foreign exchange regulations
 - better interest rates could be offered and the interest income could be made tax free.
- b. Facilitating **securitization of the future flow of remittances**, which will result in a better sovereign rating enabling local banks to raise cheaper and long term finance needed for the country's development.

Challenges Faced by the Industry

a. Transaction Cost

The cost that the remitter has to bear varies from 2% of the remittance amount and may go as high as 10%, depending on the following factors:

1. **Exchange rate margin** of the service provider
2. **Fixed fee** being charged by the service provider
3. **Tax** incurred
4. **Origination mode** (Online, branch etc.) chosen by the remitter
5. **Disbursement mode** (Cash, DD, other banks' account etc.) chosen by the remitter
6. **Revenue sharing arrangement** between the Correspondent Bank and the Beneficiary Bank

Central Banks have constantly endeavored to bring down the costs.

In October 2009, The World Bank Development Research Group published a paper on factors influencing remittance costs based on data gathered across 119 country corridors. This report reveals the following trends which could help address the issue.

- The number of migrants is inversely proportional to the remittance costs across different regions and service providers. This seems to suggest an important volume effect that works either through scale economies and/or higher competition in a large market.
- Corridors with higher income per capita in both the sending and receiving countries, exhibit on an average, higher costs, which could reflect higher prices of non-tradable goods, such as services, in general.
- Competition and market structure matter. Corridors with a larger number of providers and countries with more competitive banking sectors exhibit lower costs. On the other hand, costs are greater in corridors where banks have a higher share in the remittance business.

b. Grey Channel

The Grey Channel eats into a significant share of the remittance business. Apart from the threat it presents to the established players, it also poses a security threat since the money remitted could be used for anti-social purposes. Since this channel does not have to comply with any regulatory procedures, it offers lower transaction costs and faster TATs to the remitter.

c. Reconciliation of Remittance Transactions

Since a remittance transaction flow involves processing by multiple parties, a significant percentage of transactions are non-STP due to various reasons such as incorrect submission of details, account closure by beneficiary, system errors, manual errors by operations staff and communication gaps between the parties involved- such as failure to convey information regarding changed procedures -resulting in breach of TATs and customer dissatisfaction.

d. Revenue Sharing Arrangement

In the absence of a globally adopted standard model, the revenue-sharing arrangement between the Remitter's Bank,

Correspondent Bank and Beneficiary Bank is ad hoc, resulting in disputes and at times, disengagements between the parties.

Moving Ahead....

Though the International Remittance industry is out of its infancy, it is still evolving and catching up with the globalization process. Roadblocks and unaddressed issues continue to exist. The pace of reform is slow and the business is still commoditized. Several political, social and economic factors defining the business will have to be gradually tackled through various initiatives like

- ✓ Promoting liberal movement of labor
- ✓ Bringing progressive regulatory changes
- ✓ Delivering services efficiently
- ✓ Increasing market penetration
- ✓ Pricing products appropriately
- ✓ Managing customer relationship
- ✓ Developing innovations in technology
- ✓ Setting up a cost-effective operational infrastructure

Planned and focused efforts in the above areas combined with political will and business acumen would help this industry leap forward and contribute significantly to the globalization process.

Glossary and Abbreviations

Remitter - Person working abroad who intends to send money across the border to his family members back home

Beneficiary - Person who receives money from the remitter

Nostro - A banking term to describe an account one bank holds with a bank in a foreign country, usually in the currency of that foreign country

Vostro - Local currency account maintained by a local bank for a foreign (correspondent) bank. For the foreign bank, it is a Nostro account.

SWIFT - Society for Worldwide Interbank Financial Telecommunication supplies secure messaging services and interface software to wholesale financial entities

TAT - Turn Around Time

GDP - Gross Domestic Product

FI - Financial Institution

DD - Demand Draft

CRM - Customer Relationship Management

KYC - Know Your Customer

Central Bank - The body which regulates the banking industry within a country

STP - Straight through Processing

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Author

Akhil Nikam

Senior Consultant - Finacle
Infosys Limited



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Infosys Limited

Plot No. 44, Electronics City, Hosur Road, Bangalore - 560100. India
Tel.: + 91 80 28520261, Fax: + 91 80 28521747, e-mail: finacleweb@infosys.com
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