Reforming the Remittance Transfer Market

By Beatriz Ibarra*

Introduction

In recent years, policy analysts and economists have focused on the economic effect that remittances have on developing countries. Remittances, the money that immigrants living in the United States send to their family and friends in their home countries, account for 2.2% of Mexico’s gross domestic product, totaling $13.66 billion in 2003.1 Recent studies have shed light on the unfair practices that exist in the remittance transfer market. For example, the transaction costs of remittance transfers often exceed 20% of the total amount of the transaction,2 and this cost is often passed to the consumer through hidden fees and variations in exchange rates. Lowering the costs associated with remittance transfers by five percentage points could generate annual savings of $1 billion for Latino** households and their families abroad.3

The lack of transparency hinders the ability of Latinos to make informed choices in the short term when choosing a remittance transfer service provider, and the high costs of the transaction acts as another barrier to the accumulation of assets and wealth by Latinos in the long term. Creating transparency and decreasing transfer fees would enable Latinos to save money and begin to close the wealth gap that exists today between Whites and Latinos. Studies show that there is a significant Latino/White wealth gap in the U.S. The median net worth of Hispanic households in 2002 was $7,932, compared to $88,651 for White non-Hispanic households.4 In 2002, 25.4% of Latino households did not own any assets other than a vehicle or unsecured liabilities, compared to only 6.3% of White households.5

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** The terms “Hispanic” and “Latino” are used interchangeably by the U.S. Census Bureau to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.
Several important factors contribute to the high cost of remitting funds for Latinos, including limited access to mainstream financial institutions and lack of competition in the marketplace. Remittance tools and products are instruments that banks can use to reach out to the Latino community, relieve them of the high cost of sending remittances, and develop a mutually beneficial relationship with them. And yet, 43% of Latino remittance senders do not have bank accounts. During an 18-month period beginning in 2002, remittance products led to approximately 400,000 new accounts for the largest banks offering these products.

Several bills have been introduced in Congress that address issues surrounding remittance transfers (see box below).

There is growing interest from the financial industry and lawmakers to pass legislation that reshapes the remittance transfer market. Policies that lower the price for remitting funds while improving transparency would greatly assist Latino families’ efforts to save money or simply make ends meet. Further, reforming the way money is remitted would protect Latinos’ rights as consumers and help to ensure access to
mainstream financial institutions in the process. Such efforts can help to meet the long-term goal of fostering greater integration of Latino immigrants into American society and help many more workers to build wealth. This paper provides background on remitting behavior among Latinos, examines issues affecting Latinos’ access to remittance products, and provides recommendations for improving the remittance transfer market.

**BACKGROUND**

In 2004, the flow of remittances from the United States to Latin America reached a total of $45 billion dollars. Data collected by the Pew Hispanic Research Center show that 42% of adult, foreign-born Latinos living in the United States regularly send remittances to their family and friends living in their home country. One study found that, on average, Latinos who remit send between $100 and $300 per person, usually on a monthly basis.

On the receiving end, an overwhelming majority of remittance recipients use the funds to provide for their everyday basic needs such as food, housing, and utilities. Seventy-eight percent of remittances to Mexico was used for household expenditures, while only 8% was used for savings, 1% for investments, 1% for purchasing land or buying a house, 7% for education, and 4% for luxury and miscellaneous items.

Most Latino immigrants who remit money do not use mainstream financial institutions. Wire transfer companies, such as Western Union and MoneyGram, remain the most common means used for remitting funds. Seventy percent of Latinos living in the U.S. send remittances using a wire transfer service, whereas only 11% remit funds through a bank, 10% by hand, 7% through the mail, and 2% through a credit union. The total remittance flow from the U.S. to Mexico totals approximately $14 billion, and at least 50 money transfer businesses are competing for their stake.

Banks and credit unions maintain anywhere from 2% to 10% of the remittance market, though many are providing a variety of remittance transfer services. Some U.S. banks have partnered with banks in developing countries to allow the remittance sender to create a transfer account. The customer would then deposit funds into this account for the remittance recipient to withdraw using a specially designed ATM card. In this model, the U.S. bank will allow the remittance sender to pay a fee to transfer funds into the foreign account from his or her own personal account. In other instances, financial institutions will issue dual ATM cards linked to the remittance sender’s account. The remittance sender sends one of the ATM cards to the remittance receiver in his or her home country who can access the funds at a local ATM. The remittance sender can also control the amount that the receiver withdraws from the account. Additionally, partnerships have been formed between banks and wire transfer providers which enable a remittance sender to remit funds through a bank without having a bank account. There are many other variations on these models that financial institutions have either considered, are developing, or have tried as a means of attracting new customers.
ISSUES

Greater integration of Latinos into the mainstream U.S. financial system is an important goal. Expanded use of banks and credit unions to remit funds could be one critical means of incorporating more Latinos into the system. That said, financial institutions have been unable to compete and have yet to become major participants in the remittance transfer market. Moreover, Latino consumers lack the necessary information to make informed decisions about transfer services and products, and there is little if any federal oversight of the industry to safeguard consumers. Specific issues include:

- **Poor Market Diversification.** Many wire transfer services are conveniently located in the heart of the Latino community, often within corner drug stores, convenience stores, and grocery stores. Western Union alone has more than 196,000 Agent locations in more than 190 countries worldwide. MoneyGram has more than 60,000 MoneyGram Agent locations. A recent study showed that familiarity, convenience, and simplicity have encouraged remitters’ continued use of wire transfer companies. Additionally, many wire transfer companies now offer other services, such as check cashing and money orders. Thus, wire transfer companies have become a one-stop shop for remittance senders to take care of all of their financial needs, regardless of the higher prices they charge. The four largest banks that currently offer remittance products conduct less than 100,000 remittance transactions a month. Less than 5% of remittance transfers are conducted by the remittance sender directly depositing funds into an account at a financial institution. This is in spite of the fact that banks and credit unions often provide greater security and offer remittance products that are more affordable than the services offered by wire transfer companies. Moreover, financial institutions can provide a wider menu of financial services than wire transmitters; cross-selling can gradually bring more Latinos into the mainstream marketplace.

In 2002, the National Credit Union Administration issued an opinion letter enabling credit unions to provide remittance transfer services to nonmembers if the transfers are provided on a limited basis in order to promote membership. Unfortunately, many credit unions are unaware of this opinion and do not offer such services.

- **Identification and Other Requirements.** Even though there are a number of financial institutions offering remittance products, accessing these products still poses a challenge for many Latinos. The requirement to present a U.S. identity document when applying for a bank account is a considerable obstacle in many instances; only 70 banks in the U.S. accept the matricula consular, or other forms of secure foreign identification. Additionally, many banks still do not allow customers to use Individual Taxpayer Identification Numbers (ITIN) to open up interest-bearing accounts. Wire transmitters, on the other hand, will accept identification of any kind and only when the sender remits $1,000 or more.
Furthermore, many banks offering a remittance product also require the customer to maintain a transaction account, use ATMs to deposit and withdraw funds, and maintain a minimum balance requirement. These requirements are often a matter of policy rather than law and they effectively deter many from utilizing bank products.

Oversight, Disclosure, and Transparency. Remittance senders are often unaware of the total costs of remitting funds prior to the transaction, regardless of the remittance service provider. For example, many of Latinos are unaware that they are charged an exchange rate fee in addition to the fee charged for transmitting funds. Wire transfer companies purchase foreign currency at a "wholesale" rate and charge a less favorable "retail" rate to the remittance sender. The difference between the "wholesale" rate and the "retail" rate is known as the "foreign exchange spread," the cost of converting the remittance senders' funds into foreign currency. In many instances, a money transfer service provider will contract with another business, such as a retail store, who will receive a commission from either the remitting fee or the exchange rate fee charged to the remittance sender.

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**WESTERN UNION MONEY TRANSFER LITIGATION**

In the case, In Re Western Union Money Transfer Litigation, the plaintiffs asserted that the revenue derived from the foreign exchange rate spread constituted a fee, and the defendants failed to disclose that they were profiting from their ability to purchase foreign currency at a more favorable exchange rate than they provided their customers. More specifically, the plaintiffs alleged that the defendants engaged in racketeering, unfair or fraudulent business practices, and civil conspiracy in connection with an alleged scheme of skimming international money transfer transactions.

- **Plaintiffs:** The class consisted of all persons who used the defendants’ services to wire funds from a foreign country to the U.S. or from the U.S. to a foreign country other than Mexico. It is believed that the class consists of five to seven million persons located in the U.S. and more than 80 other countries.

- **Defendants:** Orlandi Valuta, Orlandi Valuta Nacional, Western Union Financial Services, Inc., and First Data Corp.

- **Settlement:** In addition to paying attorneys’ fees, the defendants agreed to provide class members with settlement coupons that would provide discounts on future money transfers. The defendants are prepared to distribute more than $45 million in vouchers. Lastly, the defendants must also provide written notice of the foreign exchange spread on their forms, receipts, and advertising, and establish a toll-free number for customers to call to obtain information on the defendants’ current retail exchange rates.
Thus, when such retail establishments raise their commissions, the remittance sender pays a higher price to transfer funds. Currently, neither the details of these arrangements nor the “foreign exchange spread” are fully disclosed to the consumer. Federal consumer law does not regulate or govern the remittance transfer market, so neither the wire transfer services nor financial institutions need to disclose the total cost of the transaction, including commissions. Moreover, wire transfer companies and banks post different exchange rates, which tend to fluctuate on a daily, even hourly, basis. The fluid exchange rate fee, coupled with the varying fees charged to remit funds, makes it difficult for the consumer to compare prices from one remittance service provider to the next. The lack of uniform and relevant information limits the amount of competition in the remittance transfer market.

Finally, the regulatory landscape seems to inhibit competition in the remittance transfer market. One factor is that financial institutions are required to comply with a multitude of state and federal regulations from various governmental agencies to ensure compliance with the Bank Secrecy Act, Anti-Money Laundering regulations, and the U.S. PATRIOT Act. Many smaller financial institutions fear that welcoming a large immigrant clientele will cause their institutions to become more vulnerable to investigation by federal officials. Further, many financial institutions offering remittance transfer services feel that the regulatory requirements are unclear and confusing. What is clear is that current regulations governing the market are not intended to protect consumers, but to address issues such as money laundering, suspicious activity, and day-to-day operations.

Recommendations

Reshaping the remittance market is a critical step to meeting NCLR’s long-term goal of integrating Latinos into mainstream financial and banking markets and therefore building wealth within the Latino community. Congress should enact legislation that creates incentives for financial institutions to enter the remittance market, establishes protections for consumers, and improves transparency.

1. **Increase Competition.** In order to help minimize remittance transfer costs and make the process more convenient, Congress should encourage financial institutions to offer low- or no-cost remittance services as part of a consumer’s checking or savings account. Legislation introduced in the 109th Congress by Senator Paul Sarbanes (D-MD) would extend the Electronic Fund Transfer Act (EFTA) to allow credit unions to provide remittance transfer services in addition to check cashing and money order services to their members. Additionally, networks between financial institutions in the U.S. and financial institutions abroad should be strengthened. Senator Sarbanes’ bill promotes the expansion of the Automated Clearinghouse (ACH) system for remittance transfers to foreign countries, which is one way to enable all banks, large and small, to provide low-cost remittance
services. 

2. Improve Transparency. To protect consumers who transfer funds, both financial institutions and wire transfer service providers must be required to disclose all fees on the remitting and the receiving end and disclose exchange rates prior to remitting funds. Further, all disclosures should be in languages and formats accessible to immigrants using money transfer services. Language access rules need not be overly rigid. Reasonable criteria that trigger language-accessible activities can be established. Finally, at the federal level, Congress should grant the Secretary of the Treasury the authority to create a public education program with the purpose of educating remittance senders of their rights as consumers. This program should also be language appropriate.

3. Increase Enforcement: Congress should enact legislation to ensure that remittance senders have the ability to protect their rights as consumers. Senator Sarbanes’ bill would extend the EFTA to cover remittance transactions. In addition, the bill would require the full disclosure of fees and establish a process for the resolution of transactional errors. Additionally, however, Congress should grant authority to a government entity to implement compliance reviews, conduct spot checks on samples of remittance transfer transactions, and perform audits on remittance transfer providers to ensure that transfer companies are complying with any newly-enacted legislation. This entity would also have the authority to check for rate manipulation, hidden fees, and compliance with other pertinent regulations.

Conclusion

With 43% of the Latino community remitting funds today, policies that create opportunities to save money are timely and would make a significant difference in the lives of many Latinos living in the U.S. and abroad. Congress should enact policies that reform the remittance transfer market to ensure greater transparency, increase competition, provide an enforcement mechanism, and create incentives for financial institutions to enter the market. Enacting such policies would not only ensure fairness in the remitting process, but also protect the rights of consumers who transfer funds.


5. Ibid.


10. Ibid.

11. Ibid.

12. Ibid.


15. Billions in Motion: Latino Immigrants, Remittances and Banking, op. cit.


17. Ibid.


21. An ITIN is a tax identification number issued by the Internal Revenue Service (IRS) to a person who is not eligible for a Social Security number. The ITIN is used to file report earnings to the IRS and to open interest-bearing accounts. For more information, please see, *The IRS Individual Taxpayer Identification Number: An Operational Guide to the ITIN Program*, Center for Economic Progress, 2004.

22. NCLR phone inquiry to Western Union and MoneyGram national service centers on February 27, 2005.


27. Expanding the ACH system would make it easier for financial institutions to send remittances from the U.S. to foreign countries. By improving the infrastructure to send payments, banks will be better able to exchange electronic credit and debit and settle their daily balances at the end of the day.