

Remittances: Opportunities for Senders, Recipients and Banks

Introduction

Latin American immigrants living in the United States and other developed countries sent over US\$45 billion to their families in their countries of origin in 2004, exceeding the combined flows of all Foreign Direct Investment (FDI) and net Official Development Assistance (ODA) to the region (MIF 2005). This flow of remittances even rivals the revenue their home countries receive from exports. These funds have the potential to contribute to the development of poor communities in several ways. In a March 2005 report, the Multilateral Investment Fund (MIF) summed up the importance of these funds:

Remittances are widely recognized as critical to the survival of millions of individual families, and the health of many national economies throughout Latin America and the Caribbean (LAC). Unlike foreign aid, migrant remittances go directly to families in places that are often difficult to reach with development assistance. And while international capital flows have fluctuated with market cycles, remittances have increased, even during economic recession (MIF 2005).

This paper will address how the U.S. and Latin American governments can link remittance flows with banks and other financial institutions and what the potential benefits are, including reducing the large number of “unbanked” Latin Americans (both in Latin America and in the United States), reducing the high costs of sending

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remittances to Latin America and increasing the availability of credit to poor households and rural Latin American communities, which can in turn help to reduce poverty and inequality. It will then look at efforts Mexico has taken to improve access of Mexicans at home and in the U.S. to the formal financial system through involvement with remittances.

Banking the “Unbanked”

Banks in Latin America and the United States have long failed to provide proper incentives for low-income Latinos to open bank accounts and incorporate themselves into the formal financial system (Orozco (a)). Currently up to 40-50% of Latin American immigrants living in the U.S. remain totally unbanked. Meanwhile, in their home countries, as little as 20% of the population has a banking relationship (Orozco (a)), while the percentage of remittance recipients with bank accounts is even smaller. The MIF summarized the problem as follows:

Financial systems in most developing countries generally serve only the social and economic elites of their populations. Currently, less than 10% of remittance recipients are estimated to have access to banking accounts, loans or other basic financial services. But the scale and scope of LAC remittances can be a powerful tool to open up these financial systems, and thereby multiply economic impact for millions of families and their communities (MIF 2005, 4).

Incorporating these people into the formal financial system offers potential long-term benefits for the senders and recipients as well as for banks and governments.

Provision of low cost remittance services gives banks a way to attract new, previously

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unbanked, customers, as well as a source of fee income. While banks gain from access to new customers, senders and recipients can benefit from bank services such as depository accounts and credit, as well as saving money they would otherwise spend on check cashing and money orders.

There are several different parties involved in these challenges, all with different concerns and interests. The principle actors are financial institutions, primarily banks and credit unions, in the U.S. and Latin America, immigrants and their families in their home countries, and the governments of the countries involved.

U.S. Financial Institutions

While many banks and credit unions in the U.S. appear to agree that the Latino immigrant population will be an important source of growth for their institutions, they appear to disagree on the subject of remittances. While some are actively developing their own remittance programs, and see these programs as a valuable source of both fee income and new customers, other banks are severing relationships with money transfer businesses out of concerns regarding compliance with recent anti-money laundering legislation such as the Bank Secrecy Act (BSA) and the Patriot Act, and definitely not actively pursuing the Latino immigrant market. Some of these banks may be interested in the Latino market and the growth it can offer their institution, but uncertainty regarding compliance with regulations may be preventing them from proactively seeking to bank unbanked Latinos in the United States.

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Latin American Financial Institutions

Latin American banks and other financial institutions such as microfinance institutions, credit unions and NGOs can also benefit from participating in the disbursement of remittances. This provides these financial institutions with an opportunity to reach out to “unbanked” individuals by offering one of the services they need most. It also allows these institutions to establish a relationship with potential customers and to develop the trust necessary to incorporate them into the financial system. As the Inter-American Development Bank (IADB) points out:

The business of distributing remittances also provides credit unions and microfinance institutions an alternative source of revenue to expand their lending to low-income families and micro, small and medium-size companies, particularly in poor and isolated communities (IADB 2004).

In this way remittances can play an even bigger role in the economic development of local communities than their nominal face value would suggest.

Immigrants and their families in their home countries

Immigrants and their families stand to benefit from greater participation of banks and other financial institutions in the remittance business. First, they can benefit from lower cost remittance services that result from greater competition within the market and options that banks can provide, such as international debit cards. Once they begin using a bank or other financial institution to send their remittances, they have an opportunity to

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learn more about the institution and the services it can offer them, and they can become more comfortable and more trusting of the institution. Ultimately these customers may decide to open a bank account. Once this decision has been made there are many more benefits. They will no longer pay check-cashing fees for their salary checks. Also, they no longer have to carry around large amounts of cash or keep large amounts of it in their homes, which will reduce their risk of theft. In addition to gaining a safe place to keep their money, they may also be able to earn interest on it. Establishment of a financial identity through a bank account can also facilitate access to loans with competitive interest rates. This opens up opportunities for these immigrants to purchase or build a home or to finance the establishment of a business. These opportunities can improve their financial well-being and their quality of life but would not necessarily have been available to them without access to credit (Federal Reserve Bank of Atlanta 2004).

The benefits to remittance recipients are further increased if non-traditional financial institutions become involved in the remittance business. NGOs, credit unions and microfinance institutions are generally committed to serving lower-income households and communities and are commonly found in rural communities, beyond the reach of traditional banks. These alternative financial institutions have closer links to low-income communities than traditional banks, and as a result they are likely to have a better understanding of the needs and concerns of this segment of society.

Governments

While market forces may attract some financial institutions to proactively seek previously unbanked, low-income clients, this will not always be the case. This can be compared to the case in the United States of telephone services and the use of the Universal Tax to subsidize provision of telephone services to remote areas that would not otherwise be financially attractive to telephone companies. Financial service providers may face similar challenges to providing their services, particularly in rural areas where there is low population density *and* a large percentage of the population is low-income. As a result, the most important role governments can play is in creating incentives for financial institutions to participate in areas that are “socially valuable but financially unprofitable” and to “promote financial development and give access to competitive banking services to residents in isolated areas” (IPES 2005, 142). In return governments receive benefits from the economic and social benefits that are achieved in the low-income communities that are served. Improved economic well-being can even help promote political stability. Finally, “Getting to financial institutions is critical to increase a country’s national savings and investment ratio, and a state obligation to guarantee access and service to all” (Orozco (a)).

Efforts in Mexico

As the largest recipient of remittances in Latin America, Mexico has the most to gain from this income. The challenge is to see how to make the most of these funds. One of the ways to increase the benefits of the remittances received is to use remittance flows as an opportunity to encourage both senders and recipients to work with banks, and

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to motivate banks to work with these potential customers. The Mexican government has taken several steps to facilitate the sending of remittances and to bank the unbanked in Mexico as well as the unbanked Mexican immigrants living in the U.S. These steps include issuing the *matricula consular*, making information on remittance services widely available at home and in the U.S., cooperating with the Federal Reserve in the U.S. to offer FedACH International Mexico Service, and including remittances into *L@Red de la Gente*.

The most important step taken by the Mexican government was to begin providing a form of identification that was difficult to forge and therefore carried greater legitimacy. Mexico had offered the *matricula consular* to Mexican immigrants through its embassies and consulates since the 1800s. This form of ID is now also known as the *Matrícula Consular de Alta Seguridad* (MCAS), meaning “High Security Consular Registration Document.” This document provides a form of identification Mexican immigrants can obtain regardless of their immigration status. As of March of 2002, the MCAS incorporates cutting-edge technology and 13 security features to prevent its forgery, including some of the same features the U.S. government uses for such items as FBI badges and high security visas (El Instituto de los Mexicanos en el Exterior 2004). Because the *matricula consular* is created in such a way that it is difficult to counterfeit, it carries enough legitimacy that several banks have agreed to use it as a government ID for the purposes of opening bank accounts. This has encouraged more Mexican immigrants to open bank accounts and use these banks to send their remittances home. These banks, recognizing the opportunity in front of them, have used low-cost remittance

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services as a way to attract Latino customers. As a result, the acceptance of the MCAS by banks has helped to reduce the cost of sending remittances:

The Mexican government estimates that, since the MCAS have been accepted by banks and financial institutions, the increase in use of bank transfers as a means for sending remittances has led to savings of more than U.S.\$700 million for migrants and their families (El Instituto de los Mexicanos en el Exterior 2004).

Today, at least 150 financial institutions accept Mexico's *matricula consular*—including U.S. Bancorp, Wells Fargo, Citibank, and Bank of America. Wells Fargo, one of the first banks to enter the remittance market, estimates that it has opened 60,000 new accounts since it began accepting the *matricula consular* in November 2001 (APEC 2003).

Another area in which the Mexican government has been proactive is in disseminating information regarding the U.S. banks that provide remittance services to Mexico. The Government has published information on various sites on the internet.¹ These sites provide data comparing different options immigrants in the U.S. have for sending money, including the details of each option such as the fees charged. President Fox of Mexico has also publicly addressed Mexican immigrants in the United States to inform them of ways to send money back to Mexico.² Given that many low-income Mexicans do not have internet access, it is important to point out that similar information is also available by phone. However, it is not clear how well publicized these phone

¹ See: http://www.condusef.gob.mx/transferencias_eu_mex/encarte_remesas.htm and <http://portal.sre.gob.mx/ime/index.php?option=displaypage&Itemid=118&op=page&SubMenu=> among others.

² Reproduced by the Instituto de los Mexicanos en el Exterior (IME) at: <http://portal.sre.gob.mx/ime/popups/newswindow.php?id=351>

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numbers are or how many people are able to benefit from any of this information. This information could be of greatest use if distributed in hard copy in areas where immigrants or their families gather.

Mexico has also participated in a bi-lateral effort with the United States, known as the Partnership for Prosperity, which includes a commitment to reduce the cost of remittance transfers through the formal banking system. This agreement resulted in the launch of the FedACH International Mexico Service in 2004, which involved cooperation of the Federal Reserve and Banco de México, Mexico's central bank, and allows U.S. banks to send a payment to Mexico for a surcharge of approximately \$0.60 per item, plus the standard FedACH domestic processing fees (APEC 2003, 14). It is not clear how successful this program has been. According to the website of the Mexican Procuraduria Federal del Consumidor,³ there are currently only two U.S. banks offering this service, one in South Dakota and one in Wisconsin. Although there were numerous organizations announcing the arrival of this new product, it was not possible to find anything significant written after its rollout or to determine if other banks are now offering the service. At the very least this lack of information will limit the practical benefits of this new system.

Another effort on the part of the Mexican government to use remittances as an opportunity to incorporate low-income Mexicans into the banking system is through the use of *L@ Red de la Gente*, "the People's Network." According to the organization's

³ http://www.profeco.gob.mx/html/envio/banco_fedach.htm

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website,⁴ *L@ Red de la Gente* was created so that all Mexicans, regardless of where they live or what their income is, can be incorporated into the Mexican banking system. In addition to providing other financial services, *L@ Red de la Gente* provides disbursement of remittances sent from U.S. banks and seven of the largest money transfer companies in the United States through its branches located throughout Mexico, including rural areas without access to other banking services. In order to receive remittances, recipients are required to open an account with *L@ Red de la Gente*. They then have the added advantage of keeping some or all of the remittance funds received as savings in their account. The Mexican government supports *L@ Red de la Gente* through its *Banco del Ahorro Nacional y Servicios Financieros* (BANSEFI) which is dedicated to promoting a “culture of savings,” providing banking services to *L@ Red de la Gente*, and providing technical support and other temporary assistance.⁵

Intellectual and Theoretical Influences

Facing increasingly limited prospects at home over the past two decades, workers in Latin America and the Caribbean—particularly from rural areas—have bypassed their own cities in favor of moving directly abroad. Like entrepreneurs who seek markets around the world, foreign workers cross borders in search of comparative advantages (MIF 2005).

Hidden behind the debate regarding whether or not governments and banks should facilitate the sending of remittances is the theoretical debate regarding free markets. For example, one of the arguments against accepting the *matricula consular* as

⁴ <http://www.lared-delagente.com.mx/index.html>

⁵ http://www.lared-delagente.com.mx/htmls/financiamiento_sacp/financiamiento_sacp.html

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an acceptable form of identification for opening a bank account is the idea that doing so is the same as condoning illegal immigration. Those who support it argue that we are benefiting from the labor of these immigrants, and they should have the right to access financial services regardless of their immigration status. Although the current administration has worked with Mexico to facilitate money transfers through programs such as the Partnership for Prosperity, this debate has the potential to affect future regulations. It is possible that the political environment could shift in such a way as to result in additional barriers to banking unbanked Latino immigrants.

Successes, Failures & Future Challenges

There seems to be significant progress in the United States in terms of banking “unbanked” Latinos. One of the emerging successes is a growing awareness amongst U.S. financial institutions that remittances represent an important source of potential fee income and that the Latino market in the U.S. will be a key source of growth in the future. Evidence of this growing awareness is found in a statement by Eusebio Rivera, head of Hispanic Initiatives at Bank of America, quoted in the *Wall Street Journal*, October 23, 2003, as saying: "In the next couple of years, 80% of our growth will come from the multicultural market, and 60% of that will come from the Hispanic population." Another promising sign is that U.S. bank regulators have formally acknowledged that

providing low-cost remittance services will be taken into consideration in examinations for compliance with the Community Reinvestment Act (CRA).⁶

Some banks appear to be failing to enter the Latino market due to a lack of understanding regarding the nature of the market. For example, according to Atsumasa Tochisako of Microfinance International Corporation, Bank of America reportedly has had only limited success at attracting this market because it requires customers to have an account in order to use its remittance services. These accounts require minimum balances that are too high for low-income Latino customers, resulting in monthly fees they do not want to pay. As a result Bank of America has not obtained the results they had hoped for from their remittance program.

There remain many challenges for the future. Although many banks are making entrance into the Latino market a higher priority, many others remain hesitant due to concerns regarding compliance with anti-money laundering regulations, immigrants' lack of proper identification, the potential reputation risk involved due to the controversy regarding immigration issues and doubts regarding the value of pursuing a low-value, high-volume market. Political uncertainty regarding immigration in general may also explain some of this hesitancy. Clarification of some of these regulatory requirements could help encourage more banks to pursue Latino customers. The Mexican government should work with U.S. bank regulators to encourage such clarification.

⁶ <http://www.ffiec.gov/cra/pdf/060304remittances.pdf>

Another challenge that remains is to create incentives for banks, particularly in Latin America. If serving low-income households or communities is not perceived to be profitable, the government may need to offer other incentives to encourage banks to serve these markets. The development of legislation similar to the U.S. Community Reinvestment Act (CRA) may be useful in this sense, but only if a poor rating would result in negative publicity or serious consequences of some sort for the bank. This may or may not be as effective a tool in Latin America as it can be in the U.S. Other tools that may be more effective include tax breaks or subsidized funding for banks that provide services to underserved groups. Governments could also provide similar incentives to encourage partnerships between banks and non-traditional financial institutions that already have a presence in rural and poor communities and have stronger relationships and a better understanding of their needs, but often lack funds, technology and/or financial discipline.

Furthermore, while providing low-cost remittance services is a step in the right direction for banks, it is not sufficient. Research has shown that most Latin American immigrants continue to use private money transfers services to send money home, even when it may be less expensive to use a bank or credit union. Some of the factors that prevent Latin American immigrants from establishing accounts at a depository institution include their legal status and lack of documentation, minimum balance requirements, high fees, and a general distrust of banks (Pew Hispanic Center and MIF 2002). In order to use remittances as an opportunity to bank these immigrants, these barriers must be addressed. Furthermore, banks need to adapt to the needs of these customers. According

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to one report: banks need to provide more convenient locations and hours of operation, overcome cultural and language barriers, and gain the community's trust and loyalty (Federal Reserve Bank of Atlanta 2004). Furthermore, other future challenges lie in the roots of traditionally low participation rate of Mexicans, as well as other Latinos which stems from:

... a traditional distrust of banks and citizens' unfamiliarity with the banking sector since Mexican banks have traditionally focused their services on the wealthy. This distrust extends to Mexicans' attitudes toward banking in the United States (Federal Reserve Bank of Atlanta 2004).

Some potential bank customers may need time to gain confidence and trust. By adapting to their needs and offering non-traditional services such as low-cost check cashing, banks can give wary customers a chance to integrate themselves gradually, based on their own level of comfort.

Conclusion

Although it seems to be a relatively small step, the provision of the *matricula consular* cards has provided the most apparent benefits and is the most effective action the Mexican government has taken to increase the number of "banked" Mexicans in the United States. This has allowed these immigrants to establish a financial identity and has opened the door to the numerous advantages of having a banking relationship, including a safe place to keep savings, the potential to earn interest, savings on check cashing, money

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orders and remittance fees, and access to credit. This is a relatively simple step that other countries should consider emulating, as some already have or are considering. However, given the concerns regarding terrorism in the U.S. political environment it is critical that countries that choose to pursue this make the cards secure and difficult to counterfeit, and that they manage savvy public relations campaigns highlighting how these cards can increase security in the U.S., rather than posing a threat to it.

There remain several steps the Mexican government, as well as other governments, can take in order to use remittance flows as an opportunity to connect senders, recipients and financial institutions. Governments should encourage banks to provide products that are suitable to the needs of these potential clients such as low balance requirements or fee based check cashing and money orders, in order to allow Latino customers to gain familiarity and develop confidence gradually. Governments should also pursue possible ways to promote alliances between traditional banks and alternative financial institutions. These two industries have complementary strengths and could potentially combine their efforts in such a way as to benefit their organizations as well as low-income communities and remittance senders and recipients.

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