The Remittance Industry: Implications for Regulators and Supervisors

Workshop on AML/CFT Banking Supervision - April 16-21 - Kuala Lumpur, Malaysia

Latifah Merican Cheong
Program Director, Financial Market Integrity

Coverage

1. Why the concern on remittances ?
2. World Bank work on remittances
3. AML/CFT compliance
4. Regulatory and supervisory practices
5. Lessons from US and UK

Why the concern on remittances

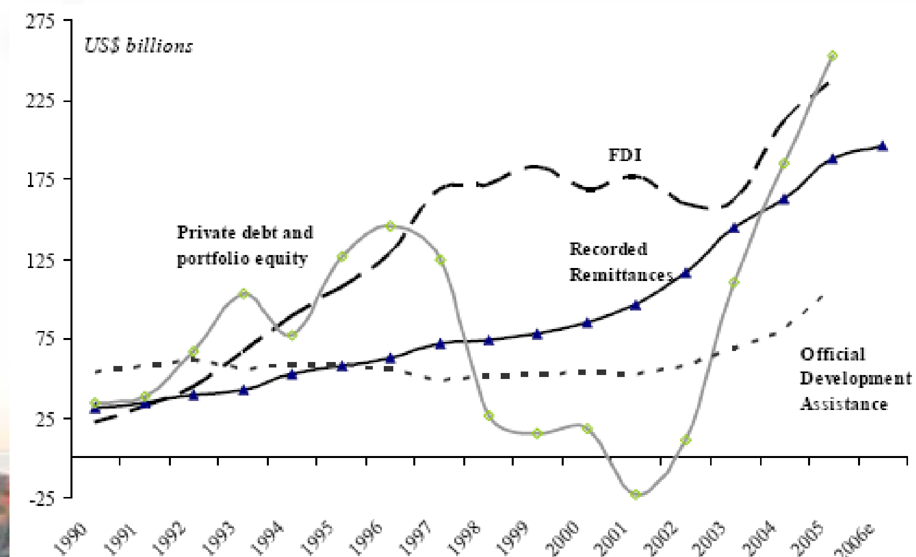
Remittance Corridors and Impact on Development

- Corridor studies support findings of development impact from remittances
- Remittances are large and rising.
- Lower middle income experience highest volume of growth ($88 billion, 86 countries), low income countries ($45 billion, 68 countries).
- South-South remittance almost as high as North-South remittances.

$ Billion	1995	2005e
Remittances[1]	85	199[2]
ODA	59	106
FDI	107	237
Private debt & Portfolio equity	126	253

1. Recorded remittances to developing countries only
2. 2006 estimates.

Remittances and Capital Flows to Developing Countries (1990-2006)



Sources: Global Economic Prospects 2006: Economic Implications of Remittances and Migration (World Bank), *World Development Indicators* 2006, and *Global Development Finance 2006*.

Why the concern on remittances

- Large volumes flowing through both formal and informal channels
- Cases of known risks of abuse to ML and TF
- Client base is diverse, represent low-income and migrant workers - - lack of financial literacy.
- Intermediaries for remittance services have a wide range of characteristics and ownership structure
- Regulatory oversight constraint by lack of information, wide range of remittance financial services, new technology and players
- Remittance senders and receivers do not have access to financial services

Why the concern with remittances

Receiver	Misuse of remittance, poor access to financial services
Sender	Disguise transfers, abuse of remittance channels
MTOs	Inability to comply with FATF Recommendations
Authorities	Poor knowledge on remittance industry - - large informal flows Difficulty for efficient, low-cost oversight Non-bank players, use of payment gateway and technologies result in conflicting role among regulatory agencies

Remittance Work in the World Bank – Corridor Analysis

Bilateral Remittance Corridor Analysis (BRCA)	Remittance & Payment Systems	Remittance & Development Impact	Data – Improving Remittance Data

1. US – Mexico
2. Canada – Vietnam
3. Germany - Serbia
4. U.S. – Guatemala
5. Netherlands – Suriname
6. Netherlands – Morocco
7. U.K. – Nigeria
8. Qatar – Nepal
9. Italy – Albania
10. U.K./ U.S. / South Africa – Uganda
11. Malaysia / Country in the Gulf Region – Indonesia
12. South Korea – Mongolia
13. U.S. – Honduras
14. Canada –Caribbean

- Similar analysis by European Investment Bank on 8 Mediterranean Corridors

- Micro-level analysis that shape remittance markets, regulatory constraints, recommendations specific to each corridor

- Complement and build upon macro-level studies by World Bank

- Impact of BRCA seen:
  - In policy responses to increase efficiency and improve integrity of remittance flows
  - Growing demand for new studies and policy advice to implement recommendations in both sender and recipient countries

Bilateral Remittance Corridor Analysis

Remittance Work in the World Bank – Corridor Analysis

Corridor	Degree of formality	Volume (US$)	Average remittance (US$)	Main mechanism
US - Mexico	High	21 bn	$367	- Electronic transfer (90%)
Canada – Vietnam	Low	N/A	Temp workers: $200-350 Viet Kieu: $1,000	- Electronic transfers - Informal channels
US – Guatemala	Medium	3.0 bn	$280-350	- Electronic transfers - Money Orders
UK – Nigeria	Low	550 mn	$350-400	- Cash courier
Germany – Serbia	Medium	238 mn	$380	- Cash courier (60%) - Electronic transfers (40%)
Qatar – Nepal	High	64.5 mn	$250-300	- Electronic transfers
Italy - Albania	Low	310 mn	N/A	- Physical transportation of cash (60%)

Bilateral Remittance Corridor Analysis

Remittance Work in the World Bank – Corridor Analysis

Regulatory Framework for Money Transfer Operators
- BRCA Remittance Sending Countries -

	US (Fed)	Canada	U.K.	Germany	Italy	Qatar	Netherlands
Authority	FIU/ Tax	FIU on reporting	Cust.	Fin. Sup	FIU	CB	CB
Licencing / Registration	Registration	No req. yet but registration regime will be implemented.	Registration	Licensing	Registration	Licensing	Licensing
Capital/ Guarantee	Not req.	Not req.	Not req.	Not req.	€ 600,000	Bank guarantee of 25% of the capital	Bank guarantee for outstanding amount
Off-site information	Not reporting	No reporting	Annual	Quarterly	N.A.	Monthly	Monthly
On-site visit	Risk-based	Not Conducted	Risk-based	On occasions	N.A.	N.A.	2-4 times/ year
STR Reporting	Req. >$2K	Req.	Req.	Req.	Req.	Req.	Req.
Threshold of Transaction Reporting	$10,000	C$10,000	Not req.	Not req.	€ 12,500	QR 30,000 ($8,242)	€ 2,000

Regulatory Framework for Money Transfer Operators
- BRCA Remittance Receiving Countries -

	Mexico	Vietnam	Guatemala	Nigeria	Nepal
Authority	Tax Authority	CB/ Fin. Min.	CB / FIU	CB	CB
Licencing / Registration	Registration	Licensing	Registration	Licensing	Licensing
Capital/ Guarantee	N.A.	N.A.	N.A.	N.A.	Not req.
Off-site information	N.A.	N.A.	On occasion by FIU	On occasion by FSA and CB	N.A.
On-site visit	On occasioin based on concerns	N.A.	On occasion by FIU	On occasioin based on concerns	N.A.
STR Reporting	Req.	Not req.	Req.	Req.	Not req.
Threshold of Transaction Reporting	$10,000	N.A.	$2,000/ Month	$2,500 (CB) $5,000 (Drug Agency)	Not req.

Remittance Work in the World Bank – General Principles

Bilateral Remittance Corridor Analysis (BRCA)	Remittance & Payment Systems	Remittance & Development Impact	Data – Improving Remittance Data

- **Assessment of Implementation of General Principles for International Remittance Service Providers**
- **Assessment of Payment Systems**
- **Technical Assistance on Payment Systems**
- **Policy work / Research**

Remittance Work in the World Bank – General Principles

Remittances as a payment system issue

- ***KEY IDEA*: Remittance services are part of the broader retail payment systems - both domestic and cross-border**
  - **Remittances are cross-border retail payments with particular access requirements (on both the demand and supply sides)**
- **An efficient domestic payment system infrastructure is key to reduce costs of remittance services, especially in receiving countries**
- **The development of payment system oversight is fundamental to enhance transparency and improve efficiency in the retail payment sector**

Remittance Work in the World Bank – General Principles

Remittances as a payment system issue

- ***<u>KEY IDEA</u>*: Remittance services are part of the broader retail payment system both domestic and cross-border**
- **The CPSS of the BIS is the standard setter and a forum for discussion in the area of payment systems**
- **The World Bank is a leading institution in payment system development, in particular in Latin America through the Western Hemisphere Payments and Securities Settlement Forum (WHF) and other regional initiatives. In the context of payment system reforms, the World Bank has recommended improvements in the remittance area since 1999**
- **Payment system development projects are a good vehicle to address the issue**

Remittance Work in the World Bank – General Principles

Implemented with BIS, the 5 principles on Remittances

Premise	Best way to reduce cost is through increasing competition
Principles	NOT call for regulation of remittances, sometimes more important to remove existing regulations
Principles	NOT to set specific service levels, low price more important than high service levels
Principles	PURPOSE is to address weakness in market that inhibit competition (including poor regulation)
Principles	VOLUNTARY, to help countries improve remittance markets
Principles	Apply to all cross-border retail payments (do NOT cover person-to-person transfers)

Remittance Work in the World Bank – General Principles

The CPSS-WB General Principles on International Remittance Services

GP1: Transparency and consumer protection

The market for remittances should be transparent and have adequate consumer protection

- **Transparency means information about the service (price, speed etc). Transparency promotes competition and should drive down prices**
- **Specially important for remittances:**
  - **"Access" problems for users**
  - **Complex to work out price**
- **What is appropriate consumer protection? Most important are probably "error resolution" procedures (RSPs' own or national schemes). Beware of the cost of some possibilities!**

GP2: Payment system infrastructure

Improvements to payment system infrastructure that have the potential to increase the efficiency of remittance services should be encouraged

- *Domestic payment infrastructure.*
- Remittance services usually depend to some extent on this. But the infrastructure may not always be very efficient, especially in receiving countries.
- *Cross-border payment infrastructure.*
- Greater standardisation to help STP in correspondent banking?
- Direct links between domestic systems as an alternative to correspondent banking?

GP3: Legal regulatory environment

Remittance services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework

- Does *not* mean special laws/regulations for remittances
- Sound, predictable, non-discriminatory ...
- ... and proportionate! Avoid danger of over-regulation. What is the problem regulation is meant to cure? Is regulation the best way to cure it?
- For key corridors, sending and receiving countries may want to cooperate if there seem to be legal obstacles

GP4: Market structure and competition

Competitive market conditions, including appropriate access to domestic payments infrastructures, should be fostered in the remittance service industry

- Importance of contestability and removing barriers to entry
- Avoid exclusivity *conditions* (as opposed to an agent *choosing* to offer only one remittance service)
- Are there problems with direct or indirect access to domestic payment systems?

GP5: Governance and risk management

Remittance services should be supported by appropriate governance and risk management practices

- RSPs face financial risk (eg if liquidity is supplied to disbursing agents), legal risk, operational risk, risk of fraud, reputational risk
- Good governance and risk management practices by RSPs make remittance services safer and help protect consumers …
- … but there is unlikely to be any systemic risk so protection measures should be proportionate to the risks

Remittances – Compliance with FATF Recommendations

Small Institutions Small

/ MSBs

FATF Rec. 4-12
Customer Due Diligence (CDD) and Record-Keeping

FATF Rec. 13-16
Reporting of Suspicious Transactions and Compliance

FATF Rec. 23
Appropriate licensing or registration monitoring

Special Rec. VI
Alternative Remittance Systems
1. Licensing/registration
2. Identification and Awareness Raising
3. Anti-Money Laundering Regulations

Special Rec. VIII
1. Wire transfers and originator information
2. Monitor suspicious transactions

Special Rec. IX
Cash couriers
1. Measures to detect the physical cross-border transactions
2. Authorities with the legal authority to stop or restrain currency or bearer negotiable instruments
3. Effective, proportionate and dissuasive sanctions

Implications of Compliance with FATF Standards

At national level

Obligation to protect integrity of financial system, minimize illegal activities

<u>BUT</u>

Have flexibility to achieve objective – onerous reporting system versus risk based approach

At institutional level

Protect Reputation
Four main requirements

Internal Control	Due Diligence (KYC)	Record Keeping	Reporting STRs

Implications to institutions

- Cost implications on due diligence & reporting obligations
- Registration/licensing obligations
- Promoting access to public and increasing market share

Approaches to Compliance with Standards

FOR NATIONAL AUTHORITIES

- **Measured policies on compliance will reinforce macroeconomic benefits of money transfers.**

Long-term benefits of:

- ➢ **Practical and enforceable regulations**
- ➢ **Gradual implementation**
- ➢ **Regulation to suit local conditions**

- ❖ **Registration or Licensing Systems**
  - ✓ **Depending on domestic conditions and regulatory regime**
  - ✓ **Tradeoffs:**
    - a) **Registration encourages entry of new firms, but requires effective oversight systems.**
    - b) **Licensing creates barriers to new entrants but protects integrity and solvency.**
- ❖ **AML/CFT requirements and preventive programs**
- ❖ **Credible sanctions for noncompliance**

Regulatory and Supervisory Practices

Challenges

- **New field – emergence of new MTOs, emergence of diversified non-bank institutions**
- **Large numbers, high cost of direct supervision - - option of differential supervision based on nature of organization and activities**
- **Risk-based supervision - - new work in FATF**
- **Effective monitoring system**
- **Exchange of information**

Regulatory and Supervisory practices

Broad Principles

1. **Objective of regulation**
- **Minimize risk to use illegal channels**
- **Protection of integrity of financial system**
- **Protection of institutional reputation (of MTOs and Banks) - - prevent regulatory arbitrage**
- **Ensure reputation of regulatory authority**
- **Corporate culture among financial institutions - - equalize between banks and non-banks**
- **Compliance with FATF Recommendation and Special Recommendations**

Regulatory and Supervisory Practices

Broad Principles

2. Measured Policies on Compliance

- Understand benefits of remittances
- Regulatory policies that reinforce macroeconomic benefits of remittances
- Understand remittance industry:
  - **Diverse client base**
  - **Diverse nature of MTOs - from banks, MSPs, taxis, convenient stores**
  - **Ownership characteristics of MTOs**
    - **Diverse**
    - **Have affiliation across borders**
    - **Lack basic knowledge of financial operations**
- Recognize long-term benefits of:
  - **Practical and enforceable regulations**
  - **Gradual implementation**
  - **Regulation to suit local conditions**

Regulatory and Supervisory Practices

Broad Principles

3. Determine underlying legal framework

- **Definition of banks and non-bank MTOs as supervision will be circumscribed by definition of MTOs**
- **Permissible activities, especially relating to foreign exchange dealership**
- **Registration or licensing systems**
  - **Depending on domestic conditions and regulatory regime**
  - **Trade offs:**
    - **Registration encourages entry of new firms, but requires effective oversight**
    - **Licensing creates barriers to new entrants but protects integrity and solvency**
- **Powers for effective monitoring systems**
- **AML/CFT requirements and preventive programs for abuse of remittance industry**
- **Credible sanctions for non-compliance with regulations, including those related to compliance with FATF Recommendations**

Regulatory and Supervisory Practices

Broad Principles

4. **Determine regulatory and supervisory regime**

- **Direct supervision - - cost, efficiency, and results**
- **Supervision through banks undertaking due diligence - - basis should be the legal framework**
- **Due diligence by banks on MTOs require monitoring of:**
  - **type of products**
  - **location and markets**
  - **anticipated account activity**
  - **purpose of account**
- **Differentiate prudential supervision and AML/CFT**

Regulatory and Supervisory Practices

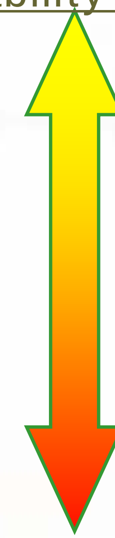
5. Compliance through risk-based approach

FOR NATIONAL AUTHORITIES

- Flexibility on compliance thru risk-based approach
- Require extensive analysis of risk for ML/TF within jurisdiction
- Data, typologies, research, due diligence & surveillance of financial service providers to establish vulnerability to ML/TF

Example of Risk-Based Approach

- Franchised multinational companies (for example, Western Union and MoneyGram)
- Franchised national companies (firms that operate in a few countries or one region (Giromex)
- Signed shop-front premises (small family-owned businesses)
- Overt ARS within other business (e.g.. travel agencies)
- Covert ARS within another business (e.g.. cargo companies)
- Covert ARS – no premises



Regulatory and Supervisory Practices

Broad Principles

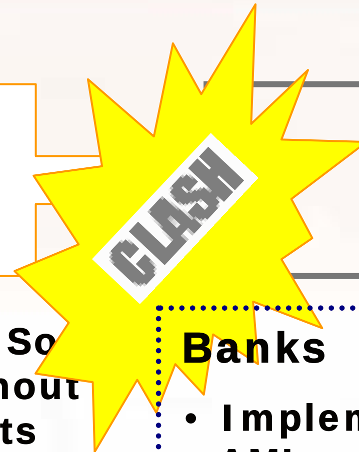
6. Adopt flexible approaches to ensure compliance with international standards

INSTITUTIONS

- Due Diligence & KYC rules to suit local conditions
  - ❖ Mexican Consular identification cards (Implemented by Mexican Government in US)
  - ❖ Letters from local/village authorities (Uganda, Tanzania & Kenya)
  - ❖ Dedicated companies affiliated to banks specialize in remittance (Malaysia/Indonesia, Malaysia/Nepal)
  - ❖ Adopt procedures for "mass banking clients" with low transaction amounts (South Africa)
- Leverage on technology for due diligence
  - ❖ Collaboration among service providers to reduce cost
- Work with regulators on measures "on a risk-sensitive basis"
- Build wider compliance cultures beyond AML/CFT
  - ⇒ Cost effective with other benefits
  - ⇒ Avoid fraud

A Case from South Africa: Tailored Approach with Local Conditions

FATF 40 in 2003 → **Local Conditions** → **Responses**



FATF 40 in 2003

- Strict customer due diligence (CDD) Requirements
- Re-identification of existing clients

Local Conditions

- Half of adult So Africans without bank accounts
- 30% of households living in informal structures
- Only 44% have formal addresses including post boxes
- 38% of accounts fall in low income market

Responses

Banks

- Implemented AML systems at huge cost
- Aggressive lobbying for changes
- Constructive non-compliance with CDD in low income market

Government

- Issued guidance note on risk-based compliance
- Delayed re-identification cut-off date

Source: Genesis

Regulatory and Supervisory Practices

Broad Principles

7. **Reporting of suspicious activities (SAR) for MSBs**

- **SAR supports minimization of the risks that the MSB will be used for illegal activities**
- **Regulations for filing of MSBs SAR when “a transaction that is conducted by, at or through the MSB is both: (i) Suspicious, and (ii) exceed threshold level”**
- **MSBs are given clear time frame to report on suspicious activities.**
- **The MSB SARs are filed in all jurisdictions of a country.**
- **The government issue guidelines aimed at helping MSBs to improve their reporting of suspicious transactions. It includes key information about the types of suspicious transactions, “red flags” to follow, the role of MSBs in reporting process, the deadlines, urgency and the importance of filing for the US authorities.**

Regulatory and Supervisory Practices

Broad Principles

8. **Balance between compliance with standards and lowering cost of remittance transfers**

- **Regulation and supervision not in isolation, but coordinated with public policy to reduce cost**

  - improve transparency
  - increase competition
  - create incentives for new technology
  - leverage on alliances & payment systems
  - increase access

- **Adopt CPSS-WB General Principles on International Remittances**
- **Promote shift away from informal to formal channels**

Thank You

Latifah Merican Cheong
Director
Financial Market Integrity
The World Bank

Email: lmerican@worldbank.org
Telephone: (202) 458-8833
Fax: (202) 522-2433