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Remittances and cross-border payments Lessons learnt

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Cross-border payments are…

- A necessary activity for individuals, companies and governments
- Typically still slower, costlier and more opaque than domestic payments, whereas constant innovation has made domestic payments more efficient

Making cross-border payments generally involves…

- More risks, complexities and rules than for domestic payments
- Worse user experience than underlying factors may explain

Different types of users = different needs…

- Preferences, experiences and challenges vary between users groups
- Companies have different needs than individuals, in terms of payments frequency, volumes, need for reconciliation with back-office systems, etc.
- Differences between MSME and big corporates
- Differences between individuals remitting money sporadically versus regularly – in particular migrant communities

Deep dive on remittances…

When not using unregulated channels, (even banked) migrants rather use MTOs and typically remit cash…why?

- Lower costs, faster delivery to the beneficiary, higher trust, "brand effect"
- Lack of access to transaction accounts on the sender or recipient side
- Migrants needs not met by banks: occasional (but regular) transactions, opening hours, costs, different KYC requirements, etc..
- Most Banks are not interested in remittances as a business

Deep dive on remittances…

Characteristics of most remittances markets

- Dominated by specialized service providers, which have developed proprietary systems and networks, and use the international cross-border interbank platforms only for the exchange of the netted and aggregated amounts.
- Cost structure has three broad components and associated compliance costs:

  (i) Costs incurred in maintaining **distribution network to originate** remittances;

  (ii) **Foreign exchange** conversion costs; and

  (iii) Costs incurred in **maintaining distribution network to disburse** remittances.

Lessons learnt by the WB over close to two decades (II)..

Non-bank remittance service providers play a key role in promoting competition and cost reduction

A number of reasons explain why banks play a minor role in the provision of remittance services:

In general many banks have not designed customized products for remittances. Same product is offered for large value, low volume and non-time critical payments.

MTOs are, in general, easier to access than banks due to their simplified documentation requirements and extensive use of agent networks that, in general, are open for longer hours and are closer to the migrant communities. When the legal framework does not allow for it, MTOs partner with banks and use their distribution network.

However, where allowed by Law, MTOs apply exclusivity agreements to their agents, thereby restricting competition

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Lessons learnt by the WB over close to two decades (I)..

In many countries, inflows represent a significant share of GDP and sometimes even more than 10 % and are often larger than exports, foreign direct investment or external aid, depending on each country's specific situation. However….

Public authorities in both sending and receiving countries are not giving strategic priority to remittances

WB country implementation experience shows that countries that have successfully lowered the cost of sending/receiving remittances have had to go through three stages of tackling the problem:

(i) According strategic priority to enhance efficiency of the remittances market;
(ii) Identifying the gaps in the functioning of the remittances market using the WB-CPMI General Principles for International Remittances framework; and
(iii) Developing and implementing a comprehensive reform program to address those gaps

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Lessons learnt by the WB over close to two decades (III)..

In many countries legal and regulatory constraints prevent the lowering of costs and better digital remittance services

In many jurisdictions a very common legal barrier is the restriction of activities of MTOs to disbursing and originating remittances in cash, implying that they cannot open transaction accounts for their customers.

While a distinction can be made, from a regulatory perspective, between MTOs that do not maintain accounts and those who engage in the issuance of e-money (as in this last case, additional requirements such as safeguarding users' funds and higher levels of capital could be applied), such regulatory restrictions do not facilitate the diversification of remittance services.

A functional approach to the regulation of payment activities, including the provision of remittance services enables different business models and competition

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Lessons learnt by the WB over close to two decades (IV)..

Remittance services are not generally integrated with the payments infrastructure

Integration of remittance services with the payments infrastructure allows for a diversification of remittance services, beyond the traditional cash to cash

The integration of RSPs with the national payments infrastructure is important from several perspectives:

Firstly, because RSPs need to move funds to carry-out their activities, and access to payment infrastructures allows them to do that in the most efficient manner.

Second, the connection between RSPs systems and payment infrastructures allows for broadening the options both to fund or disburse remittances and thereby the range of services beyond just cash to cash.

Lessons learnt by the WB over close to two decades (V)..

National ID initiatives and e-KYC reduce compliance costs and increase access

Digital ID and eKYC are promising solutions. As remittance senders need to be identified and remittances flows need to be traceable to ensure financial integrity, facilitating this process through national ID systems, including digital ID, is a critical enabler as it promotes access and reduces costs for RSPs, and also helps addressing de-risking.

There are some early signs that promoting usage of digital ID is a key enabler to reducing compliance costs. Addresses two concerns: 1) need to maintain records of conducting ID validations; 2) need to improve the effectiveness of transaction monitoring. Employing eKYC approaches address these concerns.

Lessons learnt by the WB over close to two decades (VI)..

Financial literacy activities targeting migrants and their families can be a powerful enabler

As in general remitters' behavior tends to be "sticky", better informed customers can choose the better-quality service. As choice is no longer between bank accounts and MTOs but also more innovative products, remitters are not always well-informed about these additional channels or do not necessarily trust them. Remittance prices may also be difficult to compare, and the exchange rate cost may be hidden.

Projects such as Greenback 2.0 in Turin (Italy), Montreuil (France), Johor Bahru (Malaysia), Berat (Albania), Prizen (Kosovo) and Gradacac (Bosnia and Herzegovina) help improve remitters information and education on remittances. In Malaysia, Pick Remit and "Greenback on wheels", allowed to reduce remittances fees and improve customer service.

New "all digital" players…

"Digital only" origination moved to digital channels [internet and mobile apps] funding remittances by debit to transaction account and disbursing onto another account. Advanced data analytics to estimate need for FX conversions + off-set transactions by matching and offsetting incoming and outgoing remittances. Examples: Transferwise and Xoom.

Blockchain Based models: Several players but none of them have reached any substantial scale except to a limited extent by Circle and BitPesa. Use cryptocurrencies as bridge currency + require senders and recipients to fund and receive disbursement through cryptocurrency exchanges. Also possible for "traditional MTOs" to partner for disbursing funds in some thinly traded currencies. Pilots between Ripple and big MTOs ongoing.

White-label Front-end options: Online solutions offered by a company in a white-label mode to banks and smaller MTOs. Enables banks and smaller MTOs to leverage their existing license to develop online remittance options. Examples: "times of money" platform covering USA, Canada and Middle-east to India corridors.

White-label Back-end platforms: Companies establishing banking partnerships and linkages across several countries and maintaining running balances in banks in several countries. Platform is then offered to other banks and smaller MTOs in sending countries to plug into and enable them to disburse funds to countries where they do not have a direct distribution network. Examples: Earthport and HomeSend Hub

New initiatives…

- SWIFT GPI and connection with domestic instant payment platforms (GPI instant)
- Regional initiatives leveraged for cross-border payments? (SEPA, WAEMU, EAC, SADC, API*, ASEAN*, etc..)
- Changes in national payments ecosystems driven by innovations on both sending and receiving sides
- Telcos regional interoperability for mobile payments: Orange and MTN announce pan-African interoperability
- Central Banks recognize emerging opportunities for digital transformation (BoC, MAS, and BoE)

The overall state of cross-border payments has not substantially improved over the last few years..

But, is it finally time for digital transformation?

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