

Remittances:

Their Role, Trends and Australian Opportunities



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Contents

EXECUTIVE SUMMARY	1
01 INTRODUCTION	5
02 REMITTANCES: THE ECONOMIC ESSENTIALS	7
2.1 Needs and Objectives	7
2.2 Steps in the Money Transfer Process	7
2.3 The Cost of Remittance Services	9
2.4 The Pricing of Remittance Services	10
2.5 Risk and Remittance Services	11
03 THE GLOBAL REMITTANCE INDUSTRY	12
3.1 The Size and Pattern of Global Remittances	12
3.2 Recent Trends	13
3.3 The Features and Impact of Global Remittances	13
04 REMITTANCES AND THE AUSTRALIAN FINANCIAL SECTOR	15
4.1 Providers of Remittance Services in Australia	15
4.2 The Size of the Australian Remittance Industry	17
4.3 Migration and the Growth of Remittances	19
4.4 The Pricing and Cost of Remittances in Australia	24
05 TRENDS IN REMITTANCE PAYMENTS ARRANGEMENTS	26
5.1 Common Remittance Techniques	26
5.2 Alternative Techniques and Emerging Trends	27
06 PUBLIC POLICY ISSUES	30
6.1 Financial Literacy, Information and Competition	30
6.2 Payments System Policy Arrangements	31
6.3 Consumer Protection	31
6.4 Money Laundering	32
6.5 The Australian Regulation of Remittances	32
CONCLUSIONS	34
REFERENCE LIST	36

List of Figures

Figure 1:	The Money Transfer Process, A Schematic Illustration	8
Figure 2:	The Role of Foreign Exchange in the Remittance Process	8
Figure 3:	Remittance and Other Resource Flows to Developing Countries, 1990-2014 (projected)	13
Figure 4:	Total Remittance Inflows and Remittance Inflows as a Percentage of GDP (2010)	13
Figure 5:	Total Global Remittance Inflows 2003-10.....	13
Figure 6:	Total Remittance Inflows to Developing Countries 2002-14	14
Figure 7:	Schematic of a bank and MTO collaborative arrangement.....	16
Figure 8:	Senders: Top 3 Reasons for Remitting	17
Figure 9:	Total Remittance Outflows by County 2011	18
Figure 10:	Officially Recorded Remittance Outflows, Australia: 1970-2011 (USD billion)	18
Figure 11:	Total Number of Migrants in Australia and Average Migration Growth Rate...	19
Figure 12:	The Changing Composition of Migrant Inflows	19
Figure 13:	Net Overseas Migration, Statistics and Forecasts.....	20
Figure 14:	Per cent of Adult Population with a Bank Account (Bank Account Penetration)	20
Figure 15:	Break down of Business Stay Visas Granted in 2012	21
Figure 16:	Australian Education Exports by Country (AUD Million).....	21
Figure 17:	Offshore Refugee Visa Grants by Top 10 Countries of Birth 2010-11	22
Figure 18:	Financial Inclusion in Refugee Countries	22
Figure 19:	Preferred Remittance Methods: Philippine, Indian and Chinese Migrants	22
Figure 20:	Bank Account Ownership: Australian Migrant Remitters.....	22
Figure 21:	Demographic Information: Migrants Remitting from Australia.....	23
Figure 22:	The Migrant Financial Lifecycle	23
Figure 23:	Receiving Countries of Remittance Transfers by Australian Nationals	23
Figure 24:	Average Price of Remittance across the G20 Countries, Q3 2011.....	24
Figure 25:	Cost of Remitting AUD 200 from Australia to Selected Countries, 2012: Quarter 3.....	25
Figure 26:	Remittance Cost Developments.....	25
Figure 27:	Payments Funding and Access Options	26
Figure 28:	Common Forms of Remittance Services	27
Figure 29:	Average Remittance Cost by Product Type.....	27
Figure 30:	Sample Fee Structures by Card Model.....	28
Figure 31:	General Principles for Remittances	30
Figure 32:	The SendMoneyPacific Database: The Cost of Remitting from Australia to Samoa.....	32
Figure 33:	General Principles for Remittances	33

00 Executive summary

The remittance industry provides international money transfer services to migrants and other individuals wishing to send relatively small amounts of money to families and others in (primarily) developing countries. The industry has grown steadily both internationally and in Australia, driven by migrants, consumers without bank accounts or underserved by banks, and mainstream consumers. Funds are remitted for a range of general and business reasons, including sending regular financial support to family members, sending cash for emergencies, gifting, sending funds to travellers and sending support to children studying abroad.

MARKET SIZE AND ECONOMIC IMPACT

In 2011, the World Bank estimated that USD 501 billion was remitted by migrant workers globally. Of this USD 372 billion or more was received by developing countries. Combined Australian inward and outward remittances have reached approximately USD 7.1 billion per year, according to the World Bank as measured by transactions reported to AUSTRAC. A ball-park estimate of the direct contribution remittances make to Australian GDP is in the range of AUD 336 million to AUD 588 million per annum. Remittances are a substantial contributor to the national economy and to the social welfare of recipients in developed and in particular, developing countries.

In fact, remittances are playing an increasingly important role in enhancing the welfare of families and communities and as a driver of economic development. In some countries, remittances from nationals overseas exceed direct foreign aid and foreign investment.

The potential for growth of the remittance market is substantial. There are 2 billion people in the world with limited or no access, to banking services. Among these people, the increasing globalisation of the work force means that many more millions of people are leaving their home countries to work abroad. For these individuals, convenient and fast access to

international remittance services is important to support their families at home, particularly families in rural or less developed areas. In addition, the growth of cross-border e-commerce requires new payment services accessible to small and medium-sized businesses (SMEs).

AUSTRALIAN BANKS' REMITTANCE BUSINESS

Australian banks transmit the majority of international remittances through the SWIFT network in the form of transfers from one bank account to another and as international bank drafts, with funds delivered within a timeframe of one to three days. These remittances require a customer to have a bank account during the whole or part of the transaction cycle. Australian banks currently do not serve consumers who do not have bank accounts, except for the provision of international drafts. They also do not serve consumers, including their own account holders, who require end-to-end service to areas unserved or under-served by banks, or who need to send cash to recipients virtually instantaneously.

MONEY TRANSFER OPERATORS (MTOS)

Specialist money transfer operators (MTOs) such as Western Union, MoneyGram, and a large range of smaller institutions and informal operators have developed the networks, technology, and skills to provide virtually instantaneous transfers of funds between individuals in disparate parts of the globe, including rural and less served areas.

MTOs lead transfers where the principal for remittances is in the USD 1,000 to USD 5,000 range. Remittances higher than USD 5,000 are normally conducted through banks. Providing service at lower levels particularly in countries with poor financial services infrastructure is a resource-intensive and costly activity that banks have been unwilling or unable to replicate.

COLLABORATION TREND

Banks tend to have large, widespread, domestic or regional branch networks and provide banking services on Internet and mobile phone platforms to customers. Increasingly, banks are combining these assets with the geographic penetration and international expertise of MTOs to provide lower-value remittance services to consumers at reduced costs and greater convenience.

There is considerable scope for greater collaboration between Australian deposit takers (banks, credit unions and building societies) and MTOs which could substantially reduce the cost of providing remittance services and could lead to increased use of the services and greater overall revenue.

In addition, there is an opportunity for deposit takers and MTOs to work with other companies, such as mobile phone service and credit card providers, to further increase access to, and the availability of, remittance services in developing economies. Mobile phone-based remittance services, as illustrated by the *M-Pesa* model in Kenya, involving SMS transfers of phone credit and widespread cashing-out facilities is a case in point. Such services could change the shape of the remittance industry.

Traditional MTO operators have also benefited from the growth of international and domestic “e-commerce” involving small-scale transactions between individuals or SME sellers and buyers of goods and services. More dedicated services such as PayPal – partly due to its association with EBay – have grown within this sector and are a potential source of competition for MTOs, but generally limit transactions to consumers with accounts with, or access to, financial institutions.

COST TO CONSUMERS

The high fees faced by migrants and others for making remittances have been an issue of concern for policy makers both in Australia and internationally. In Australia, non-governmental organizations, governments and multilateral agencies have been critical of the level of remittance fees, which appear high by world standards. Governments and international agencies tend to attribute high remittance fees to inadequate competition or exploitation by some operators of poorly informed customers. Actions to address any such issues are appropriate – but there may be greater scope for fee reductions through policies which address impediments to lowering resource costs incurred by remittance providers. Direct measures by MTOs to simply lower fees may be appropriate in some cases, but there is greater scope to reduce fees

through policies that address impediments to lowering resource costs incurred by remittance operators in making or facilitating transfers.

A significant cost relates to foreign currency conversions. MTOs reduce costs for retail customers, compared to individual bank transactions, by aggregating and batching the foreign exchange transactions while providing virtually instantaneous transfer of value for the customers. By doing so, however, they take on the resulting foreign exchange risk, or conversion component risk, arising from customer transactions.

Transactions from bank accounts to physical cash or involving pre-paid cards have the lowest fees internationally. This highlights the potential for cost savings from greater collaboration between Australian banks and MTOs who together could facilitate the disbursement of cash associated with transactions initiated from Australian bank accounts, or develop card-based products that can be used in countries where Australian banks are not well represented.

Fees charged for remittance services reflect, in part, the underlying resource costs and small transaction sizes involved, so that any such bank-MTO collaboration which reduces costs in the sending country, can provide a valuable contribution towards achieving Government and multilateral agency goals of reducing remittance fees. It can, of course, only provide a partial contribution, because a substantial cost component lies in providing disbursement facilities in receiving countries where financial systems are often relatively underdeveloped and problems of financial inclusion exist.

BOX 1: THE CASE FOR COLLABORATION

Remittance fees in Australia appear high by world standards. In part this reflects the particular characteristics of the recipient countries involved. The average cost, estimated by the World Bank, of remittances from Australia to Pacific Island countries is above 12 per cent of the amount transferred (for a \$200 transaction). In contrast, remittances to Pakistan had an estimated cost of around 8 per cent. Fees charged by formal MTOs (Western Union, MoneyGram etc) are significantly less than those charged by banks. Reflecting this, transactions between bank accounts (except between accounts at the same bank) are more expensive than those involving cash. But transactions from bank account to cash, or involving pre-paid cards have among the lowest fees internationally. This highlights the potential for cost savings from greater collaboration between Australian banks and MTOs who are able to facilitate the disbursement of cash associated with transactions initiated from Australian bank accounts, or develop card based products which can be used in countries where Australian banks are not well represented.

REGULATION

In the past, questions have been raised about compliance standards in the MTO sector. The Australian Government has taken a global leadership position in its response to the perceived risk of remittance transfers with the recently strengthened Anti-Money Laundering and Counter-Terrorism Financing Act (2006 – section 6). A major outcome of this revamped legislation is the requirement for any provider of remittance services to apply through AUSTRAC for inclusion on the Remittance Sector register. The more stringent reporting and registration requirements coupled with the public availability of the register and enforcement of digressions suggest that Anti-Money Laundering and Counter-Terrorism Financing risks associated with compliant remittance service providers have been significantly reduced as a result of AUSTRAC's actions.

But greater regulation has another consequence. It contributes to remittance costs, and so may inadvertently prevent development of more efficient practices and processes. Reviewing regulatory arrangements for payments services and deposit taking may be warranted with the growth of new transferable stores of value (such as phone credit), access devices (mobile phones, tablet devices etc) and access channels (Internet, phone networks).

In addition, improving access to, and reducing the cost of, remittance services in Australia is a worthwhile and important public policy goal. The resulting greater flow of remittances to developing countries can contribute to their social and economic development and welfare, perhaps even more effectively than foreign aid or investment.

OPPORTUNITY

The remittance industry is continually evolving with existing operators constantly facing new challenges, including competition from alternative forms of payment. How these will affect the competitiveness of the more traditional business model of MTOs, which involve large-scale networks of physical 'agents' to overcome the costs created by geography and location, remains to be seen.

However, formal MTOs such as Western Union and Money Gram have particular skills and network advantages that make them well placed to adapt to such challenges through collaboration with providers of emerging technologies. Similarly, banks have been and may continue to be, unable or unwilling to duplicate internationally these skills and network advantages,

implying that opportunities for collaboration exist to reduce service provision costs for the mutual benefit of both customers and industry participants.

With a high level of ongoing migration (and temporary workers) projected, and involving many from countries where remittances are an important feature of economic and social arrangements, the scope for continued growth in remittances remains large.

Intra-APEC remittances are growing as a result of increased labour migration within the region fuelled by strong GDP growth and an aging population. The Australian banking sector has the opportunity to expand its reach and revenue potential by merging its technology with, and drawing on the significant resources of MTOs to expand services beyond its traditional national borders, particularly to those countries at the nation's door-step.

01 Introduction

The remittance industry provides valuable economic services, particularly to migrants and guest workers from developing countries who wish to send money internationally to support family and friends in their home country. For many developing economies remittances are a major source of international capital flows (exceeding foreign aid and debt and equity portfolio investments) and contributing to economic growth, financial sector development and the alleviation of poverty.

Globally, remittances are in the order of USD 500 billion p.a., and Australia was estimated by the World Bank to be the 19th largest source of remittances in 2011, at USD 3.7 billion, with the amount having grown substantially over the past decade. Much of the remittance outflow emanating from Australia goes to Pacific Island and Asian nations reflecting migration patterns and development levels in the receiving countries.

The major providers of remittance services in Australia are specialist Money Transfer Operators (MTOs) such as Western Union and MoneyGram and the Australian banking sector – although banking sector involvement is less than might be expected given its overall size and importance in the financial sector. There are also many smaller MTOs¹ which may specialise in providing services in particular “corridors” (pairs of countries), as well as an “informal” sector – the existence of which means that official figures understate the true size of remittance flows (quite substantially for some corridors).

The MTOs which operate globally have developed extensive worldwide networks of collection and disbursement agents, and skills and processes, which enable them to accept money from individuals in one country (such as an AUD amount in Australia) and make it accessible, virtually instantaneously, to individuals in

another country in their home currency. Traditionally this process has involved acceptance and disbursement of cash (in different currencies), but there are a range of alternative processes now in use (including account and card based transfers) which are discussed in Section 5.

Technological development threatens to change the shape of the remittance industry, particularly through the opportunities which widespread growth of mobile phones provide for enabling money transfers to “unbanked” individuals in developing economies where financial inclusion is low. The *M-Pesa* mobile phone based money transfer service in Kenya (discussed in Section 5) is one example at a national level which attracts much attention. How such developments, and potential for new types of remittance products, may affect competitive positions and business models of alternative remittance service providers remains to be seen. But they do highlight the potential for new forms of collaboration between MTOs and other entities which can contribute to bringing down the “high” costs of remittance services.

Fees charged for remittance services are generally seen (internationally) as being high. That reflects, at least in part, the significant resource costs involved in the process of enabling small scale transfers of funds to be made between disparate parts of the globe, although policy makers continually express concern about inadequate competition and exploitation (by some providers) of poor, and poorly informed, consumers.

An important objective of this paper is to identify ways in which the cost of providing remittance services from Australia (which are relatively high compared to other developed nations) can be reduced. A second objective is to build greater awareness of the economic and social importance and features of the remittance sector, such that potential participants and policy makers can contribute to its beneficial development. Given the potential changes arising from technological advance, a

¹ These include: Money Move IT, Aussue Forex & Finance, Orbit Remit, Coinstar, Ria, Sydney Forex, Citilink Finance, KlickEx, Secure Cash Xpress, Digicel Mobile Money, Xpress Money, M-PAiSA, IMEX Money Transfer, and a number of other operators which tend to specialise in remittances to particular countries.

third objective is to provide insights into how the sector may evolve in the future.

There appears to be significant untapped potential for reducing remittance costs via greater co-operation and collaboration between key players in the industry such as the major Australian banks and the global MTO's. The former have extensive branch networks and electronic banking facilities which can facilitate the low cost collection of funds from those wishing to make remittances. They do not, however, have the widespread disbursement facilities of the MTOs in developing countries to which remittances are to be sent where financial inclusion is often low, nor do their foreign exchange processes easily allow for virtually instantaneous access by the recipients to funds remitted.

Because regulation can sometimes impede desirable innovations and developments in the financial sector, it

is also important for policy makers to better understand the nature of the remittance sector. That includes recognising that with remittances being primarily cross-country in nature, differences between countries in the speed, type and acceptance of new technologies, financial literacy, and regulatory and institutional arrangements are all important drivers of potential and feasible change.

In Section 2 we provide more detail on how the remittance process operates, and this is followed in Section 3 by an overview of the size and trends in the remittance industry globally. Section 4 focuses on the remittance industry in Australia, including providers, users, sources of growth and costs. Section 5 provides more detail on the alternative types of remittance products available and emerging, while Section 6 examines some of the public policy issues relevant to the sector. Section 7 concludes.

02 Remittances: The Economic Essentials

2.1 NEEDS AND OBJECTIVES

The remittance industry meets the need of individuals who wish to transfer money to another individual (or themselves) in another place. Where it is not possible, or extremely costly, to physically effect such transfers of money personally, individuals engage the services of various types of agents to arrange the transfer. While typically associated with international transactions, domestic money transfer services between individuals or with micro-enterprises are also important – and becoming increasingly so with the development of e-commerce. Box 1 provides a brief history of remittance services.

BOX 2: A BRIEF HISTORY OF REMITTANCES

The remittance process has existed for many centuries. It evolved in South Asia as the *hawala* system, although it appears to date back to around 700 AD during the Tang Dynasty in China as the *fei-ch'ien* system. Tea merchants from the South of China would provide any revenue generated from the sale of goods in the Northern Capital to the tax office in that city. In exchange, the tax office would provide the merchant with a certificate. When the merchant returned home to the South of China, they could exchange the certificate to the provincial government office and receive a refund on the cash they had deposited in the northern capital. Buencamino and Gorbunov¹ provide an overview of the origins and practices of such informal remittance services.

While that process enabled merchants to avoid carrying cash (and associated risks) on their return journey, and did not involve transfer of funds to a different person (as in modern day remittances), the process involved illustrates the valuable economic function provided by remittance services. Purchasing power is transferred to a person in a different location rapidly and safely. In the process, services such as conversion into a different currency, information provision (notification of the transfer to the recipient and of its successful completion to the initiator),

1 (Buencamino & Gorbunov, 2002)

continued on next page

In engaging agents to provide money transfer services individuals will be concerned with issues such as:

- **Risk** – of the transaction being completed and funds delivered safely to the recipient;
- **Speed** – with which the transaction is completed and funds available to the recipient;
- **Convenience** – how much personal time and effort is involved for both the sender and receiver in undertaking the transaction;
- **Complexity** – how easy is it for the sender and receiver to understand the service provided and nature of fees charged; and,
- **Cost** – how large are the fees charged by the service provider, and what form do they take.

2.2 STEPS IN THE MONEY TRANSFER PROCESS

Figure 1 provides a schematic illustration of the money transfer process, with the sequencing of transactions and actions indicated in brackets. It illustrates the importance of both information flows and monetary flows, as well as the need for cooperation and trust between the domestic and foreign agents involved in receiving and paying out money. (For large formal MTOs acquiring and disbursing agents will be contracted in some form of affiliate relationship, while informal money transfer operators rely on strength of relationships. In some cases, informal arrangements may be based on a courier physically transporting cash).

In most cases the remittance process occurs in three phases, the funds capture phase, the funds disbursement phase and the communications and settlement phase². In the funds capture phase an individual goes to a commercial bank, MTO or any other remitter and provides funds to be transferred to a third

2 Annexes 2 and 3 of (Committee on Payment and Settlement Systems & World Bank, 2007) provide more detailed information.

and verification (of the recipient's identity) are also provided.

While remittances today are typically thought of as involving transfers from emigrants back to their home country, the reverse flow was also common historically, giving rise to use of the term "remittance man" to describe expatriates from the UK (and elsewhere) living in colonial countries and supported by funds from their home country.

Over time, the scope of remittance services has increased, influenced by large historical waves of mass migration. The geographical distance over which funds could be transmitted has increased and transactions involving foreign exchange currency conversion have become dominant. The number of providers, both formal and informal, has increased, with private sector operators (rather than governments) playing the dominant role. However, government agencies, particularly the postal services, have played an important role. In 1878, the Universal Postal Union introduced postal money orders, enabling remittance payments to be made internationally through the postal network³. Postal services also operate in partnership with private operators as collection and disbursement centres. However, until very recently, the underlying process of remittance transfers had not undergone any significant change.

³ (Lysdal & Rientra, 2012)

party overseas. In the funds disbursement phase the remitter either disburses the funds through one of their branches in the receiving country or uses an agent to disburse the funds to the recipient.⁴

In the settlement stage of the international remittance process the remitter must settle the transaction involving different currencies across borders. For many large remitters this is largely an in-house accounting process that is undertaken through a centralised corporate treasury function, which does large scale foreign exchange transactions reflecting its overall flows of funds as required. However for smaller remitters that use third-

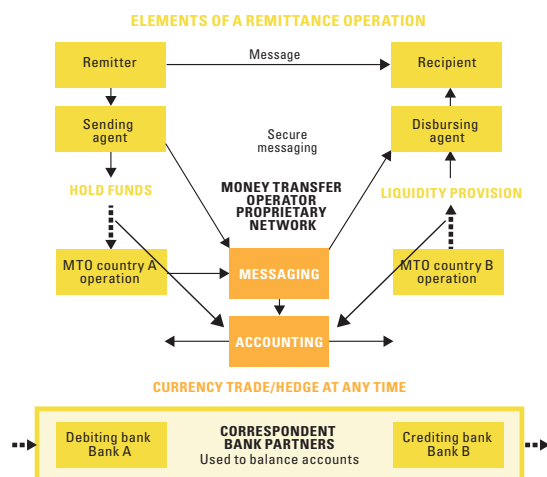


Figure 2: The Role of Foreign Exchange in the Remittance Process

Source: (Andreassen, 2006)

party disbursement agents, a third-party intermediary, usually an international bank, is used to wire funds to the disbursement agent's bank account⁵. Lags between fixing the exchange rate for the customer and undertaking the corresponding foreign exchange transactions create risks for remitters, which can either be hedged or the risk assumed on their own trading accounts. Compensation for that risk-bearing may be reflected in fees charged to customers. Figure 2 illustrates the role of foreign exchange in the remittance process.

The development of a network of agents and/or branches is fundamental to the business models of large scale money transfer operators (MTOs), enabling them to provide such services between a wide range of points on the globe. At the same time, specialist informal providers of remittance money transfer services may operate only in one "channel" involving two countries or regions between which there has been substantial migration, and where regular flows between specific locations and the same parties do not require development of large networks.



Figure 1: The Money Transfer Process – A Schematic Illustration

Source: Derived from World Bank Remittance Inflows data.

⁴ There are a number of different processes a remitting firm can use to ensure the funds are disbursed to the correct recipient. ID checks and codes sent to a recipient's mobile phone are two of the more common procedures.

⁵ Some informal services which rely on business relationships between acquiring and disbursing agents might make the required settlement by, for example, over or under-invoicing for a trade transaction between them to reflect funds paid out.

Thus, there are a variety of business models which are feasible ranging from one extreme in which all operations are undertaken within a single company, to the alternative where each component of the transaction is between separate entities. In practice, most business models will involve some combination of internal transactions together with use of third parties as agents or suppliers of particular services. In that latter regard, one important component of cross-border transactions involves conversion of money provided in one currency into provision of money in a different currency, thus requiring involvement in the foreign exchange market and the services of banks.

It is worth noting the difference in business models between MTOs and Banks, who also provide facilities for sending money internationally, as this explains the importance of the remittance industry outside of banks. First, individuals wishing to send funds via the banking system will generally need to have an account at the sending bank. Second, the transfer of funds to an overseas bank branch will occur simultaneously with the transfer of (limited) information about recipient identity, and has typically involved some lags. Third, the recipient will need to have an account at the receiving bank – which is unlikely to be a branch of the originating bank. Thus, banks have typically not had, nor developed, the same breadth of acquiring and disbursement agents in a range of countries as have MTOs, and have not allowed access to funds to the recipient until the inter-bank transfer has been completed. Thus, while use of bank access to the SWIFT⁶ network for foreign exchange transactions is ultimately a necessary part of MTO operations, the remittance industry has thrived by overcoming inefficiencies in the global banking transactions market for retail customers which banks have been unable or uninterested in resolving.

In order for a bank to operate in the same manner as a global MTO, they would be required to either build their own proprietary network of international branches/agents or create a series of bilateral agreements with individual international banks. The first of these options would require a significant fixed cost of establishing international branches or building relationships with potential agents as well as the cost associated with understanding local markets and regulations. Bilateral agreements would incur less fixed costs but would be time consuming and each agreement would have to be negotiated individually.

A third option is for banks, particularly in sending countries such as Australia, to establish relationships with MTOs enabling use of their widespread branch networks and e-banking facilities for the initiation stage of a transfer, and use of the MTO's special skills in the transfer and disbursement stages. By reducing collection costs and providing increased accessibility to individuals wishing to remit funds, there is potential for reducing remittance costs and facilitating the growth of this socially valuable service. Not only would this provide an enhanced range of services to existing customers, but the potential exists for attraction of, and building relationships with new customers, such as newly arrived migrants, wishing to use remittance services. And to the extent that MTOs are specialist providers of a single service (speedy international retail money transfers) with which banks do not compete, there is little risk of loss of other business through collaboration.

Figure 1 also enables identification of a number of the potential changes facing the industry which are discussed in section 5. One is the method of payment between customers and the MTO, which has traditionally involved currency or transfers out of and into bank accounts (or other acceptable media), but where the possible choices may expand substantially, to include such things as transferable phone credit as technology continues to evolve. Another is the method of accessing services which has historically involved physical attendance at the agent's office, or use of postal facilities, but now involves the internet or telecommunications channels.

2.3 THE COST OF REMITTANCE SERVICES

Such developments have implications for the future cost of providing money transfer services, an issue of worldwide political concern for some time. In 2009 at the L'Aquila Summit, for example, the G8 countries called⁷ for a reduction in the cost of remittances of 50 per cent. Such calls are generally based on perceptions that high fees charged for remittances reflect the exploitation of market power, or of customers who have low levels of financial literacy and are therefore unable to assess the true cost or compare alternative fees of services they are purchasing.

Those perceptions may have validity in certain cases, but it is important to recognise that the business of providing money transfer services is, as Figure 1 should suggest, an activity which involves significant resource costs for providers, which need to be recouped in fees charged. The typical remittance transaction

6 SWIFT (the Society for Worldwide Interbank Financial Telecommunication) enables foreign exchange transactions between its member-owner banks (see <http://www.swift.com/>).

7 (G8 Summit 2009, 2009)

involves a relatively small sum of money, and not inconsequential time spent in documenting, processing and verifying transactions, including meeting regulatory and compliance obligations. Enabling convenience and speed of transactions for senders and receivers at diverse locations involves expenditures on physical assets or agency arrangements, and costly transactions with third parties such as banks, in the case of foreign exchange. Box 2 provides an idea of the average costs

BOX 3: DETERMINANTS OF MONEY TRANSFER COSTS

To illustrate the resource costs in remittances, consider a quite simple, “low-tech” example of a money-transfer operator with an office in both a sending (high income) and receiving (low income) country. Assume: 16 transactions per day (4,000 annually); one full time worker in each office costing USD 40,000 per annum in the high income country and USD 20,000 per annum in the low income country; office rental costs of USD 10,000 and USD 5,000 per annum respectively. The assumptions about transaction numbers and labour costs imply approximately 30 minutes average time for each transaction in each office. That does not seem unreasonable for a range of activities involving receipt of forms and money, documenting and initiating transactions, notifying participants and verifying identities, banking and arranging currency exchange, meeting regulatory and compliance requirements.

Average labour costs per transaction are thus USD 10 and USD 5 in the two countries and recoupment of office rental costs per transaction are USD 2.50 and USD 1.25 respectively. To this should be added marketing, advertising and office consumable costs, a required return on, and of (depreciation on) physical capital employed in the business, and costs such as foreign exchange conversion costs paid to banks. Aggregating the components, an average cost per transaction of approximately USD 20 is implied, such that a similar fee charged per transaction would not involve abnormal profits. For an individual remittance transaction size of, say, USD 200 (which is relatively common) the required fee is thus in the order of 10 per cent of the amount transacted.

These calculations are illustrative only, and costs could vary (both above and below) depending on technology, business models and amounts of business transacted. In this regard it is worth noting the analysis of MTOs in the UK by DMA (2010) for UKAid, which provides information on cost structures. Their findings include: “cost of compliance is found to be approximately 2% to 10% of operational costs”; “bank charges amount to approximately 10% of revenue earned on each transfer when depositing cash at the bank”; and “the agent-to-agent model has an intrinsically high cost due to its structure (up to 60% of revenue is spent directly on commissions to agents) which means profit margins are low. This is especially the case for smaller operators...”⁸

8 (Developing Market Associates, 2010, p. 7)9 (CFPB, 2011, p. 13)

which might be incurred in a remittance transaction – assuming an “old-fashioned” technology.

Because the average size of remittance transactions is small, the average cost of performing each transaction (including recovery of fixed costs) is relatively high, consequently fees will appear high relative to transaction size even in a perfectly competitive environment. That is not to say that excessive fees might not be charged by some operators, nor that improvements in technology and communications cannot reduce average costs. Indeed, there is considerable variability in remittance fees between different types of market participants and between country corridors (pairs of sending and receiving countries). Beck and Peria⁹, for example, find that fees are lower for corridors for which migration has been large – which could reflect economies of scale or increased competition in larger markets. Similarly, there are significant differences between the fees charged by informal operators, MTOs, and banks, with banks generally charging higher fees than MTOs. While these differences could reflect differential costs due to differences in technology used, they could also reflect exploitation of “local market” power – if other operators do not service those corridors.

2.4 THE PRICING OF REMITTANCE SERVICES

Remittance pricing can be complex. Remittance service providers can be expected to vary the prices of transactions “based on a range of factors, including the specific sending and receiving locations, the size of the transfer, the speed of transfer, the method of payment, and the method of pickup.”¹⁰ All of these factors influence the resource costs involved as well as the risks faced by the remittance service provider.

There are three main elements that make up the total cost to the consumer of a remittance transaction. 1) The explicit fee charged at the time of transfer by the sending service provider, 2) fees charged at the time of disbursement by the service provider in the recipient country, 3) the exchange rate applied to the transaction. While the explicit fees charged by the sending service provider (and possibly the disbursement agent) are obvious to the remitter, the cost incurred through the exchange rate “spread” can be less transparent and difficult to interpret. Box 3 provides an illustration of the issues involved.

The foreign exchange spread on remittance transactions has the appearance of a pure profit for the remittance provider. However, it must be recognised that it is not possible for individual small transactions to be made

9 (Beck & Peria, 2009)

10 (CFPB, 2011, p. 13)

BOX 4: EXCHANGE RATE SPREADS

The cost of the exchange rate spread is often viewed as the difference between the exchange rate offered by a remittance service provider and that offered in the foreign exchange wholesale market. Take the example of a US migrant to Australia who wants to remit \$100 Australian Dollars back to his family in the United States. The exchange rate he is quoted by a remittance service provider is 1 US dollar per Australian Dollar and the wholesale exchange rate is 1.028 US dollars per Australian dollar. The exchange rate spread is 2.8 per cent. Rather than receiving the USD 102.8 dollars that would have been sent had the migrant had access to the wholesale rate, the migrant's family would receive only USD 100 dollars. The spread therefore represents a 2.8 per cent transaction cost. The spread can vary greatly depending on the remittance service provider, and currencies involved. Thus, for example, another provider might quote an exchange rate of 0.99 US dollars per Australian dollar – which is a larger spread and, because fewer US dollars are received, involves a higher cost to the customer. In comparing alternative remittance providers, it is important to recognise differences in the exchange rate quoted. In the US, the Dodd Frank Act includes specific requirements for clear disclosure of the exchange rate involved.

at wholesale market rates. Physical resource costs are incurred in aggregating a large number of transactions into a parcel large enough to obtain wholesale market rates. As Andreassen¹¹ notes, “remittance firms offer opportunities for cost savings. International wire transfers through banks are costly and slow. Remittance firms ‘bundle’ a number of transfers, send the bundled funds through the banking system, and ‘unbundle’ the funds at the other end. In this way, the settlement charges are spread over many remittance transactions. In this way, remittance firms reduce the cost of transferring funds.”

The time involved in doing so also exposes the provider to foreign exchange risk when a fixed price is provided to the retail customer, for which some compensation might be expected. How large the various costs and information is an empirical matter. It would be expected that competition and adoption of best practice information and transactions technology would drive these costs (and the spread) down over time, and that this effect would be greater in those channels (country pairs) where there is a large volume of business.

Globally the prices of remittance services have been decreasing, 2011 statistics from the World Bank show that the global average cost of remitting has decreased from 9.81 per cent in 2008 to 9.3 per cent in late 2011. The reduction in price in the G8 countries is more pronounced, with the price dropping from 10.26 per

cent in 2008 to 8.53 per cent over the same period¹². While the average price of remitting from Australia is still well above the global average current domestic and global developments are expected to see this cost decline further, thereby promoting further growth in remittance transactions. G8 initiatives to promote competition in the industry and empower customers with price comparison services may quicken the trend – although whether less financially literate consumers using informal remittance providers will effectively use those services is open to question.

2.5 RISK AND REMITTANCE SERVICES

The main risk for a user of remittance services is the risk of non-completion of the transaction and loss of money provided to the MTO. A further risk is the possibility that the amount of funds received by the recipient differs from that expected, due to incomplete information about fees which might be levied upon collection or the exchange rate involved in the transaction.

Such risks can be expected to be greater when informal remittance services are used, and particularly where transactions are infrequent or one-off in nature, although Rees¹³ reports that a survey of users of informal services in Australia did not elicit any significant evidence of problems. For other MTOs the establishment and maintenance of a reputation for reliable service is a crucial part of the business model to ensure repeat business and word-of-mouth advertising.

In some countries such as the UK, remittance operators will come under the remit of Financial Ombudsman services which, as well as providing an avenue for dispute resolution, may also involve imposition of regulations on pricing structures and information provision arrangements. In Australia, individuals can take complaints to the Financial Ombudsman.

As remittance services continue to evolve, some of their activities take on some of the attributes of banking. There are two aspects to this. The first is when customers are provided with facilities to build up amounts in an account at the service provider which can be subsequently used for making remittances or other payments, those accounts start to resemble bank deposits. The risk exists of the service provider going into liquidation and the funds being lost. The second aspect is that such account balances may become acceptable as a means of payment by a sufficient number of individuals. The remittance provider is then providing an alternative to the bank based payments system which should have some degree of inter-operability.

11 (Andreassen, 2006)

12 (The World Bank, 2011b)

13 (Rees, 2010)

03 The Global Remittance Industry

In this section we focus primarily upon the role of remittances from migrants and foreign workers. Remittances play an important role in the global economy. More than USD 501 billion dollars were remitted globally in 2011, and such remittances provide a relatively stable and much needed capital inflow for many underdeveloped countries. Remittances aid in the alleviation of poverty and can also provide capital to fund household investments and savings in emerging countries.¹

The term “remittances” can be used in a number of different ways in discussions of international financial flows. Box 5 provides guidance to the official definitions used by international agencies and in construction of official balance of payments statistics. Figures on remittances produced by international agencies on this basis are particularly relevant for understanding consequences of migration for economic development in the migrant’s home country. It should be noted however that official figures for remittances are generally believed to be substantially understated. In addition to the formal remittance services provided by banks and Money Transfer Operators, such as Western Union and MoneyGram, a high volume of informal remittances occur by methods such as sending cash with friends.

Consequently, official figures also do not necessarily provide good information about the scale of money transfer service activities or opportunities available to participants in the remittance industry.² They do not, for example, capture the need for international money transfers arising from foreign travel or parental support of international students. Moreover, E-commerce, is changing the need for money transfer services beyond those traditionally associated with transfer payments (such as from migrant residents or guest workers in one

BOX 5: REMITTANCES – OFFICIAL BALANCE OF PAYMENTS TERMINOLOGY

Remittances are generally defined as the sum of the following three components. Each can involve both credit (inflow) and debit (outflow) items in the balance of payments

- (a) **Workers Remittances** = current transfers of funds by migrants who are residents to individuals, such as family members, in another country
- (b) **Compensation of employees** = wages and salaries for work in countries other than where they are residents (ie wages of guest/temporary workers)
- (c) **Migrant transfers** = net worth of individuals transferred when they become residents of another country

country to family members in another country). There is increasing need for provision of payments services associated with internet and other long-distance digital purchase transactions. As noted by the BIS³, “the [E-commerce] market holds potential for cross-border payments, for which the current range of efficient payment instruments is still limited and again not always in line with user needs”.

3.1 THE SIZE AND PATTERN OF GLOBAL REMITTANCES

In 2011, the World Bank estimated that USD 501 billion dollars were remitted by migrant workers globally. Of this total, USD 372 billion or more than 70 per cent of the total was received by developing countries⁴. However, official figures are likely to substantially understate total remittances due to the use of informal channels. Freund and Spatafora⁵ estimate that informal remittances range between 35 to 75 per cent of formal remittances for the set of developing countries they examine.

1 (Catrinescu, Matloob, Matloob, & Quillin, 2009)

2 For example, the item compensation of employees (such as payments to foreign guest workers) may not involve any physical remittance of funds to the home country, if all that income is used by the worker for consumption.

3 (Committee on Payment and Settlement Systems & Bank for International Settlements, 2012, p. 49)

4 (The World Bank, 2012c)

5 (Freund & Spatafora, 2005)

Migrant remittances comprise a crucial proportion of monetary inflows to many developing countries. Recent statistics from the World Bank show that migrant remittances provide a larger capital inflow to developing countries than both official development assistance (ODA) and private debt/equity portfolio investment combined. Only foreign direct investment (FDI) makes up a larger proportion of capital inflows. (See Figure 3)

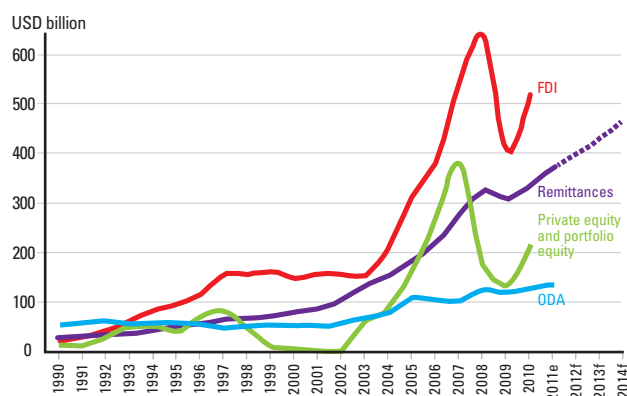


Figure 3: Remittance and Other Resource Flows to Developing Countries, 1990-2014 (projected)

Source: (The World Bank, 2012c)

Traditionally, the largest recipients of remittances have been developing nations that have a large percentage of the working age population emigrate internationally to earn wages and partake in opportunities that exceed those offered in their home countries. This was true in the 19th century when the largest remitters came from Spanish, Italian and Irish migrants and remains

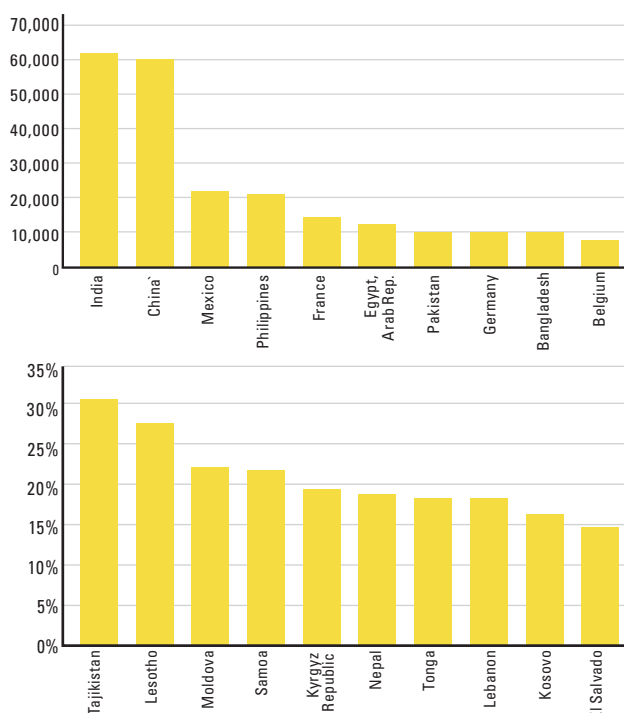


Figure 4: Total Remittance Inflows and Remittance Inflows as a Percentage of GDP (2010)

Source: Derived from World Bank Remittance Inflows data⁶.

true today with the largest remittance inflows being received by India, China and Mexico.

While gross dollar (or other currency) measures provide an indication of the largest remittance corridors and indeed the largest emigrating countries, a more important measure for many developing countries is the value of remittance inflows as a percentage of the country's total GDP. Remittance as a percentage of GDP shows the relative increase in spending power of residents made available by such unrequited transfers from overseas. For some developing countries this can be anywhere up to 30 per cent. Not surprisingly the top 10 recipients of remittance inflows (relative to GDP) are underdeveloped countries with wealthier neighbouring countries. Two of Australia's neighbours, Tonga and Samoa are included in this list. (See Figure 4)

3.2 RECENT TRENDS

Prior to the Global Financial Crisis, total remittances were growing at an average annual rate of around 20 per cent from a base of approximately USD200 billion in 2003. However, 2009 saw the rate of growth decrease sharply with an annual growth rate of negative 5 per cent for the year (Figure 5). Growth in the sector has subsequently moved back into positive territory although forecasts from the World Bank suggest that growth will not resume at its pre-GFC rate with predictions falling in the 7-8 per cent range through to 2014.

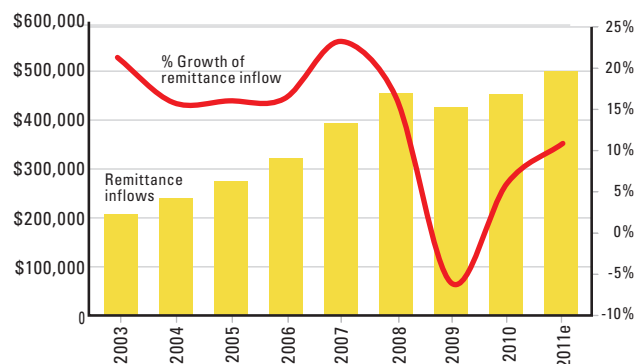


Figure 5: Total Global Remittance Inflows 2003-10

Source: Derived from World Bank Remittance Inflows data.

Remittances to developing countries have followed and are forecast to continue on a very similar trend to that of total remittances over the last decade (Figure 6). This is not surprising given that remittance inflows to developing countries during that time have tended to make up more than 70 per cent of total remittances.

3.3 THE FEATURES AND IMPACT OF GLOBAL REMITTANCES

There is a vast literature researching and assessing the features and impact of global remittances. It has

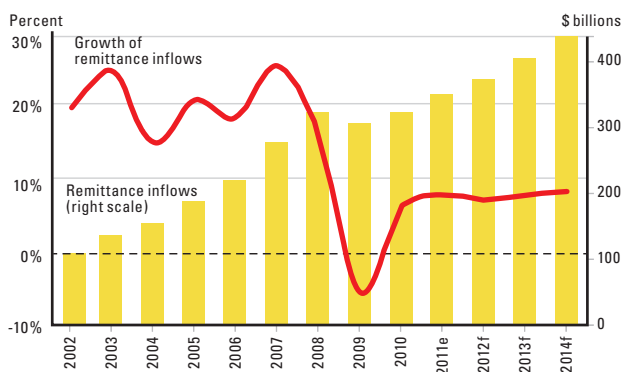


Figure 6: Total Remittance Inflows to Developing Countries 2002-14

Source: (The World Bank, 2011a)

already been noted that for many developing countries, remittances received exceed foreign aid receipts and make a significant contribution to the Balance of Payments. Inflows from this source enable higher levels of national expenditure and imports. Giuliano and Ruiz-Arranz⁷ find that remittances can assist economic growth in developing countries, consistent with the hypothesis that they provide an alternative source of funding for investment when financial markets are underdeveloped. Faini⁸ examines the argument that remittances may be an offset to the “brain drain” of educated, skilled, workers which developing economies may face due to higher income potential abroad, and that the scale of such remittances may provide a better financial return on the human capital involved than if emigration had not occurred. However, his empirical estimates give a negative relationship between skilled emigration and remittance flows.

It has also been documented that remittances are more stable over time than other capital inflows, thereby having less consequences for exchange rate volatility (or balance of payments crises). Chami et al⁹ also find evidence that higher levels of remittances contribute to greater stability of output growth in developing countries, since their magnitude tends to vary inversely with economic activity in the receiving country.

Various studies have examined the determinants of patterns and volumes of global remittances. Naturally, patterns of migration are important. And while remittances of migrants decline with the length of time in their new country, there are still significant flows for many years. Governments of some countries have also tried to tap into their diaspora as sources of funding as direct investment or purchasers of sovereign debt for investment needs in the home country. “Diaspora Bonds” are thought by some to involve lower cost of

funding because of emigrants desire to contribute to development in their country of origin and lesser concerns about sovereign risk.

Yang¹⁰ provides a recent survey of much of the relevant literature. Migrants (and casual workers) may remit funds for reasons ranging from altruism to support consumption of relatives, providing funds to enable relatives to buy air travel to visit, through to the making of personal investments in their home country. They may also have a demand for savings facilities in both their country of domicile and country of origin, such that entities able to provide both remittance services and deposit accounts in both countries may have some competitive advantage. Typically, relatively small amounts are sent in relatively frequent transactions which, given the large fixed cost element in remittance fees, raises obvious questions about the causes of such behaviour. It is also apparent from research findings that remittance volumes are to some degree sensitive to changes in fee levels. Lower fees increase the number (and/or size) of transactions undertaken, although an elasticity of less than unity means that total fees paid are less. Relatively stable receipts of remittances may act as an insurance buffer against economic fluctuations for recipients.

7 (Giuliano & Ruiz-Arranz, 2009)

8 (Faini, 2006)

9 (Chami, Dalia, & Montiel, 2009)

10 (Yang, 2011)

04 Remittances and the Australian Financial Sector

4.1 PROVIDERS OF REMITTANCE SERVICES IN AUSTRALIA

Official figures on the relative importance of different providers of remittance services in Australia are not publicly available, but it is a large industry with a significant number of participants. The Regulatory Impact Statement for proposed legislation relating to Anti Money Laundering provides some information: "AUSTRAC estimates that there are around 6,400 providers of remittance services in Australia"¹. Of those, around 400 are independent operators using their own systems and processes to provide remittance services.

Most of the remainder are affiliates of large network providers, of which there were approximately 25 in 2010, or of intermediaries who have relationships with the large network providers.² For those affiliates, which include newsagencies, post offices, and convenience stores etc, remittance services are often only a small part of their business activities. One large network provider had over 800 affiliates, four had between 40 and 800, and the remaining 21 had less than 40 affiliates.

Remittance providers are required to report transactions to AUSTRAC, with around 20 million reports being received annually with a total value of around AUD 7.3 billion in 2009-10. These figures suggest an average transaction size of around \$300, although the median size is probably somewhat less.

Industry information shows that the remittance market in Australia is dominated by two Money Transfer Operators and the four major banks: ANZ, Commonwealth Bank, National Australia Bank and Westpac. Western Union is by far the largest of the MTOs with more than 510,000 agent locations across more than 200 countries. MoneyGram is the other major operator with around 240,000 agent locations across 196 countries. Both operate worldwide. Many of the other MTOs specialise

in specific corridors, such as iRemit which specialises in remittances to the Philippines.

Amongst the major MTOs, Western Union provides the largest range of remittance services for retail customers, offering both retail based transfers and account based transfers. Currently, MoneyGram only offers retail based transfers in Australia. Retail based transfers are a more traditional form of remittance service whereby the remitter of funds provides documentation and the funds to be remitted in-person to an agent or branch of the remittance service provider.

Account based transfers require the sender or receiver of the funds to own a bank account. Account based money transfers offered by Western Union provide the option for a sender to access their account through the on-line banking portal and transmit through a Western Union hot-linked connection. Receiver-driven account based money transfers let the receiver log in to their on-line banking portal and 'pull' the remittance received into their bank account. The send or receive ability of account based money transfers is that it empowers the individual to move money anywhere in the world within minutes.

The benefit of account based transfers is that they allow for a more integrated and efficient remittance service and are generally offered at a lower cost compared to retail based transfers. Account based transfers can be enacted online, via a mobile phone and do not require the sender of funds to physically visit a remittance service provider or agent and typically require less documentation to be supplied by the sender. Both of these factors also translate to a lower variable cost for the service provider. As they can be enacted online, account based transactions also provide the sender of funds a 24/7 service.³ Account based options allow recipients to receive funds directly into their bank

¹ (Attorney General's Department, 2010)

² These figures do not include banks and other Authorised Deposit Taking Institutions.

³ It should be noted that MoneyGram also provide senders of funds with a 24/7 service via their partnership with 7 Eleven which provides cash-to-cash remittance services.

account or in some countries, as is explained below, into a mobile phone based account.

Technological change and industry developments mean that traditional MTOs face new competitive challenges. The growth of mobile telephony, means that providers of mobile phone networks have the infrastructure to provide money transfer services. In principle, individuals can purchase mobile phone credits, transfer that credit to another individual via SMS, with that individual able to exchange the credit for cash at an agent of the network operator. *M-Pesa*, which has been successful in Kenya provides an example of how such a system can work, although widespread application to international, and domestic, money transfers requires cooperation between various domestic and foreign network operators. While a potential competitive challenge, such developments may also provide opportunities for traditional MTOs. There are already examples of traditional MTOs partnering with mobile remittance providers to provide efficiently parts of the payment process infrastructure (such as disbursement agents) which mobile phone network operators may lack.

Another challenge arises from the banking sector. As 99.1 per cent of Australians own a bank account, the four major banks in Australia have access to a large number of potential remittance customers via cross-product promotion. However, in addition to the higher cost associated with bank remittance transfers, an issue with the remittance services provided by

Australian banks has been the time associated with completing a remittance transfer. The four major banks all offer remittance services or “international money transfers” however the expected time for a transaction of this nature to be completed ranges from 2 to 5 days depending on the bank and destination of the funds being transferred. This compares to MTOs and smaller remittance service providers who generally complete transactions in a matter of minutes.

As mentioned in Section 2.2 of this report, the large difference in time taken to complete remittance transfers comes from the banks reliance on SWIFT for remittance transfers. The SWIFT process, which requires the transfer of funds to be completed prior to the disbursement of funds into the receiving account, is considerably slower than the proprietary network developed by MTOs, which is essentially the transfer of information from one agent to another with the funds being settled through a central treasury function at a later date. The time associated with bank remittance transfers may be reduced in the future as SWIFT has relatively recently developed SWIFTRemit as a service enabling member banks to better perform international remittance transfers.⁴ It provides standardised correspondent bank templates and messaging and settlement arrangements which can enable banks to establish relationships with correspondent banks overseas for rapid transfers of funds from their customer to a customer of the correspondent bank. By allowing for the use of mobile phone numbers as identifiers for

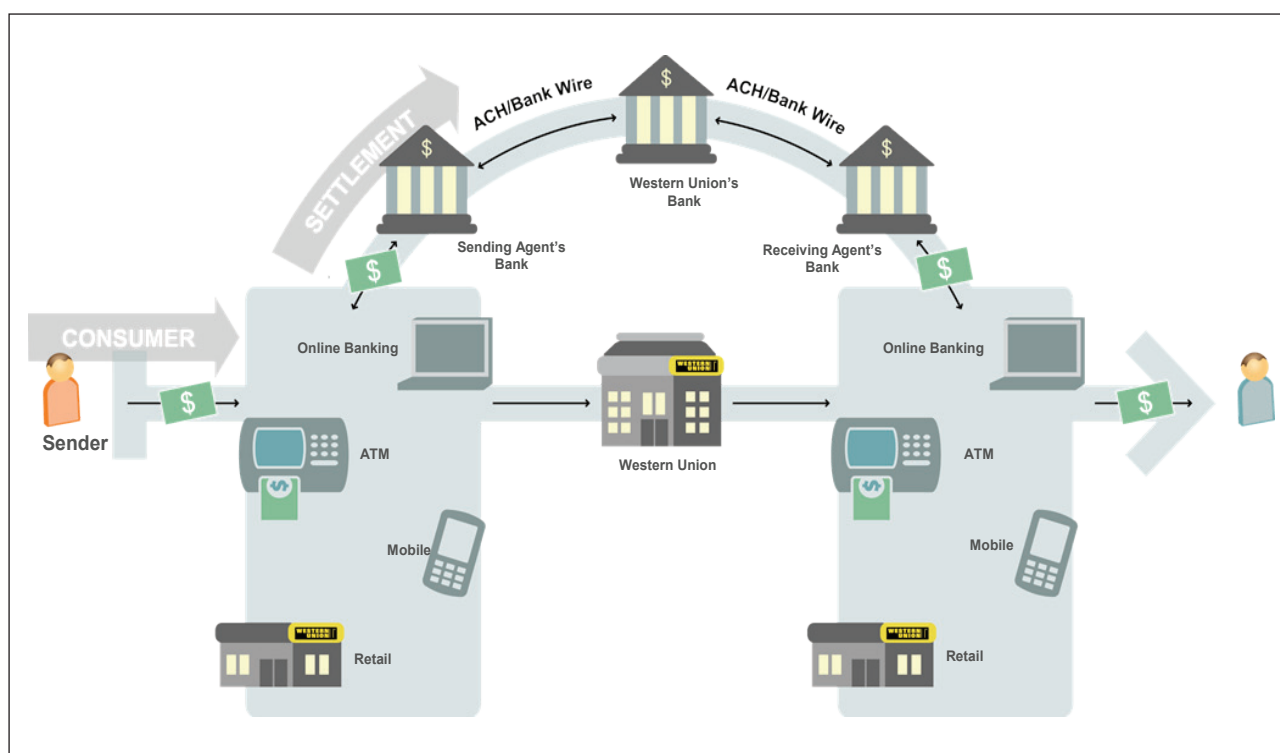


Figure 7: Schematic of a bank and MTO collaborative arrangement

Source: Cross-Border Money Movement Services for Financial Institutions, Western Union 2012

4 (SwiftRemit, 2012)

BOX 6: THE CONTRIBUTION OF THE REMITTANCE INDUSTRY TO GDP

There are no official figures on the contribution of the Remittance industry to Australian GDP. However, it is possible to make some ball-park estimates, and the Australian Centre for Financial Studies estimates that the contribution is in the region of AUD 336 – AUD 588 million per annum.

The first step required is to estimate total revenue of the industry. Noting the alternative definitions and figures for remittances provided earlier in this report, we take AUD 4 billion and AUD 7 billion as low and high estimates of the remittance amounts facilitated by the domestic industry per annum. Some part of that may be inward remittances, where the domestic industry receives “abroad-agent” disbursement fees, while outward remittances will involve international disbursement fee payments to agents abroad. Based on available remittance cost figures (see subsequent sections), total industry revenue is estimated at 12 per cent of those figures, giving AUD 480 and AUD 840 million. From this needs to be subtracted the amount of intermediate inputs to the production process (purchases of goods and services from other firms). Information from the accounts of large and small deposit taking institutions and Australia Post, as organisations which perform some of the same functions, would suggest estimates of the ratio of intermediate inputs to total revenue of 0.3 to 0.5.

UK estimates of MTO costs by DMA⁵ are, when rent, IT costs and payments to overseas agents are taken into account, at the lower end of this range (although varying dependent on the type of business model). Recognising also that some part of the volume figure derives from inward remittances for which revenue is likely to be lower than we have assumed, we assume a figure of 0.3 for intermediate inputs/total revenue such that contribution to GDP is assumed to be 0.7 of total revenue. Applying this figure to a revenue range of AUD 480 to AUD 840 million gives a ballpark estimate of direct contribution to GDP which ranges from AUD 336 to AUD 588 million per annum.

5 (Developing Market Associates, 2010)

payment instructions, the potential exists for using the correspondent bank branch network to enable payments to be made and collected even by individuals who are not customers of that bank. Another strategy being employed by banks internationally to reduce the time associated with remittance transfers is collaboration with MTOs. The large proprietary global network of distribution agents controlled by MTOs eliminates the banks reliance on the SWIFT network for remittance transfers and also expands the banks’ potential customer base by allowing it to service transactions whereby either the sending or receiving party does not have a bank account. A collaboration of this nature could feasibly drive down the cost of remittances through greater economies of scale and also increase the

number of migrant families with access to remittance services. Western Union has already engaged in similar arrangements with more than 80 banks internationally. Figure 7 provides a graphical representation of how this arrangement works.⁶

The remittance sector is a significant contributor to employment and GDP – both directly and via its demand for inputs from other sectors. While there are no specific figures available on the numbers employed by the sector, the existence of 6,400 providers indicates that at least that number of individuals is involved in the sector – although many of those would be involved in a part-time capacity running agencies in conjunction with their other business activities. Similarly, there are no specific figures for the sector’s contribution to GDP, but Box 6 provides an estimate. More generally, the contribution made to social welfare by provision of valued services to migrants and others should not be underestimated.

4.2 THE SIZE OF THE AUSTRALIAN REMITTANCE INDUSTRY

The demand for international money transfer services reflects a number of different needs. Migrants and workers on temporary visas wish to send money home on a regular basis. They, and others, wish to send money occasionally as a gift or to meet emergency needs. Parents need to send money to their children studying abroad, and individuals wish to have access to money while travelling abroad. Digital, on-line, shopping is adding yet another dimension to the demand for these services. Figure 8 presents the aggregate findings of two Western Union surveys. The first asked for the primary reasons for the sending and receiving of remittances by Chinese, Philippine and Indian migrants living in Australia. The second asked the same questions of Chinese, Indian and Philippine residents receiving remittances from Australia. (The percentages indicate how often that particular reason was mentioned). In both cases support, which includes living expenses and child support payments, is the most common reason, with “gifting” also being important. Also noticeable is how frequently urgency of

MIGRANTS LIVING IN AUSTRALIA SENDING TO:

PHILIPPINES

- Support
- Gifting
- Urgent

INDIA

- Gifting
- Support
- Financial payments

CHINA

- Support
- Gifting
- Urgent

Senders: Top 3 Reasons for Remitting

6 Note that the SWIFT network does not feature in this diagram and is instead replaced by the MTOs proprietary network

payments is mentioned.

In this section we focus primarily on the past and future growth associated with migration. Remittances also play an important role for the families and communities of migrants who receive funds from an overseas migrant (See Box 6). A study by Dilip Ratha finds that “a 10 per cent increase in per capita official remittances may lead to a 3.5 per cent decline in the share of poor people [ie the percentage of population below the national poverty line]” (Ratha, 2007). Remittances have been shown to reduce poverty in a number of countries albeit with varying success across countries.⁷

Remittances by migrants and foreign workers from Australia in 2011 were estimated at USD 3.7 billion dollars by the World Bank. On this basis, the World Bank estimates that in 2010, Australia was the 19th

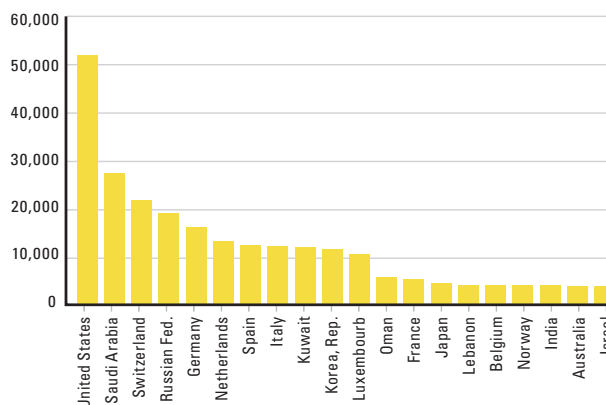


Figure 9: Total Remittance Outflows by Country 2011

Source: (The World Bank, 2012a)

largest provider of remittances in the world (See Figure 9). These World Bank figures are consistent with the ABS Balance of Payments figures which for 2011-12 give an outflow figure for workers remittances of AUD 944 million, and compensation of employees of AUD 3,308 million. Remittance debits have shown steady growth in recent years and were AUD 3.99 billion in 2008-9, AUD 4.11 billion in 2009-10, and AUD 4.30 billion in 2010-11.¹¹

A comparison of the value of total remittance outflows (using the official Balance of Payments definition) from 2000 to 2010 highlights the exceptional growth the Australian remittance sector has experienced in the last decade. In 2000, the total value of outward remittances barely exceeded USD 1 billion dollars meaning that the nominal value of outward remittances has grown by more than 250 per cent over the period (see Figure 10). A component of this growth which is measured by the World Bank in USD can be explained by the Australian dollar's appreciation over the greenback however even after converting the outflows into an Australian dollar equivalent there is still a 136 per cent increase.¹²

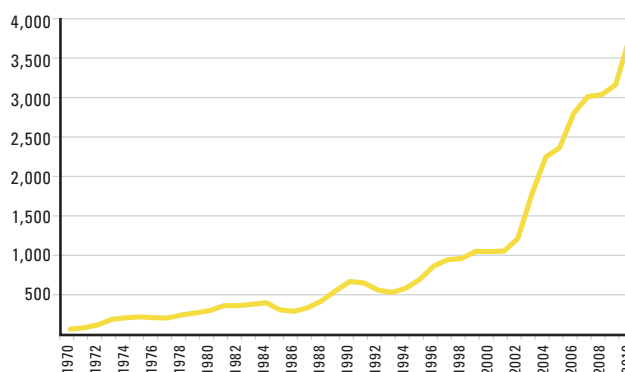


Figure 10: Officially Recorded Remittance Outflows, Australia: 1970-2011 (USD billion)

Source: (The World Bank, 2012a)

BOX 7: EXPERIENCES OF AUSTRALIAN REMITTERS

According to a study conducted in 2009, one Cook Islander resides in Australia for every 3.5 in the Cook Islands. While not as extreme, the ratios of 1:9 and 1:13 for Samoa and Tonga respectively highlight the importance of Australian employment and remittance services for residents of these Pacific Island nations.⁸ In fact, as highlighted in Figure 4, the Pacific Island nations have amongst the highest ratio of remittances to GDP in the world. For both Tonga and Samoa remittances make up around 25 per cent of total GDP and for the Cook Islands estimates put the figure closer to 35 percent.

For these countries remittances can promote economic development, provide employment opportunities for residents of countries with poor economic growth and reduce poverty. A World Bank study also found that remittances may promote savings, investment and human capital.⁹ The study suggests that these positive externalities may extend beyond the household of the migrant and produce positive spill-over effects to the wider community receiving remittances.

A survey conducted by Brown, Leeves and Prayaga in 2010-11¹⁰ on migrants from these three Pacific Island nations now living in New South Wales found that respondents would on average remit between AUD 6-8 thousand a year. While the majority of remittances were transferred to the migrant's family, almost one quarter of funds remitted were received by church groups and other households in the migrant's home country. Interestingly, around 16 per cent of remitted funds were used for asset accumulation in the migrant's home country.

The survey results suggest that remittances do encourage savings and investment in developing countries and that the effects of remittances can also have positive spill-over effects for the wider community of receiving countries.

⁸ Bertram, 2009

⁹ Brown et al., 2006

¹⁰ Brown et al., 2012

¹¹ ABS Balance of Payments and International Investment Position, Australia, March 2012, Cat No 5302.0

¹² This was estimated using the RBA historical exchange rate of USD/AUD of .6583 recorded on the 4th of January 2000.

But for the providers of money transfer services, alternative measures may provide better indicators of the demand for their services. Those figures for the formal definition of outward remittances are roughly matched in magnitude by other current transfer debits recorded in the balance of payments statistics at around AUD 3.5 billion per annum, with these transfers also requiring the use of international payments services. Adding those figures gives a total of potential outward (non-business) flows with which money transfer operators could be involved in originating of around AUD 7 billion per annum. Inward current transfers (credits in the balance of payments) are also in the vicinity of AUD 3.5 billion, and domestic money transfer operators may play a role here in disbursement of funds, or as global operators by providing both the sending and receiving services.¹³ Around AUD 7.3 billion of transactions were reported by MTOs to AUSTRAC in 2009-10 which, recognising that some part of remittance payments are made by banks (and not included in those reported transactions), is compatible with the figures above.

4.3 MIGRATION AND THE GROWTH OF REMITTANCES

There are a number of potential explanations for the growth in remittance outflows. One is simply the scale of migration which has led to a significant increase in the migrant population over time (see Figure 11). Close

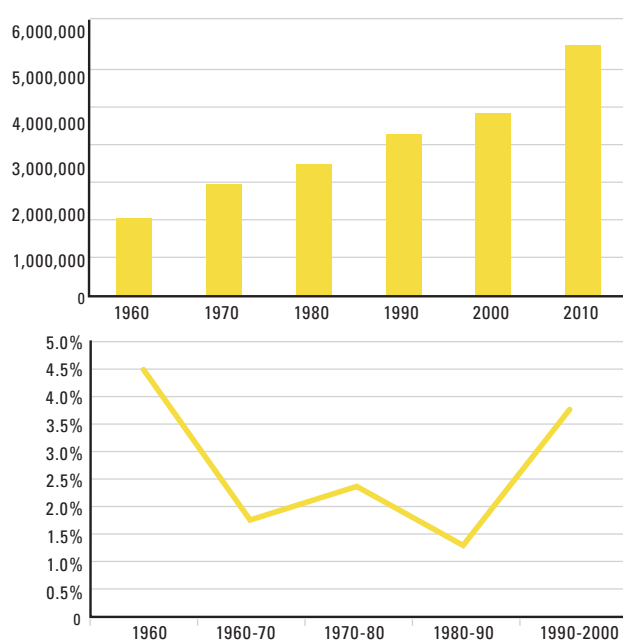
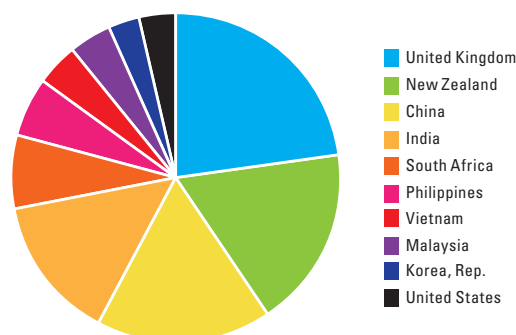


Figure 11: Total Number of Migrants in Australia and Average Migration Growth Rate

Source: Derived from the World Bank Bilateral Migration Matrix 2010 (The World Bank, 2010)

¹³ Unfortunately, the official figures do not separate out remittances from other current transfer credits.

2000 to 2010 Migration Breakdown



2010 to 2011 Migration Breakdown

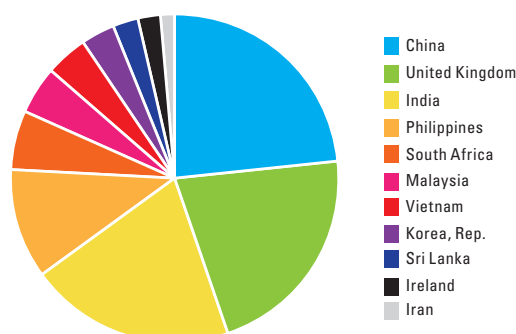


Figure 12: The Changing Composition of Migrant Inflows

Source: Derived from World Bank the World Bank Bilateral Migration Matrix

to 1.5 million new migrants came to Australia in the last 10 years.

Another is the composition of migration – for example, there has been a sharp increase of migrants from countries with large remittance inflows (see Figure 12). Chinese, Indian, Philippine and Vietnamese migrants make up more than 23 per cent of total Australian migrants over the last decade and the proportion of migrants from these countries has continued to increase in recent years. Furthermore, Australia's neighbouring Pacific Island nations rely heavily on remittances as sources of capital. Samoa and Tonga are estimated to rank among the leading recipients of remittances in relation to GDP for all developing countries and the primary sources of these remittances to Pacific Island nations are Australia, New Zealand and the US.¹⁴

It can be expected that migrant remittances will continue to grow. Net annual immigration of close to 200,000 is forecast for coming years (Figure 13) with slightly more than half of those arrivals being temporary (including guest workers) and the remainder permanent.

Whether continued migration flows will increase total remittances is dependent on whether this inflow of new migrants offsets the number of long-term migrants that reduce or stop sending remittances. Studies show that there is an inverse relationship between the duration of

¹⁴ (Australian Government & New Zealand Government, 2010)

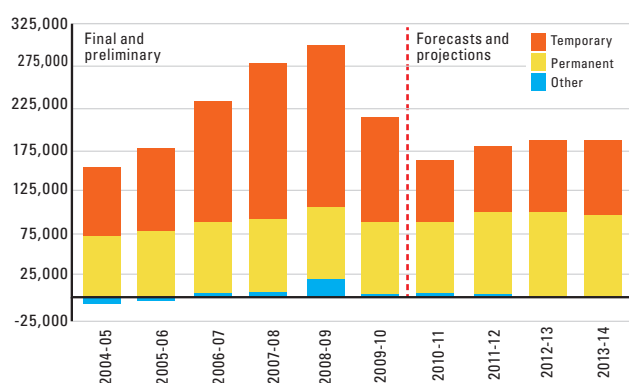


Figure 13: Net Overseas Migration, Statistics and Forecasts

Source: (Department of Immigration and Citizenship, 2011)

stay in a destination country and the level of migrant remittances.¹⁵ Another determinant will be changes in the cost and ease with which remittances can be made. The development of new technologies such as mobile money transfers, electronic purses and remittance cards means that the number of people without access to remittance services in recipient countries will decrease.

When discussing migration and its implications for the demand for remittance services, it is worth noting that Australian migrants are heterogeneous in their reasons for coming to Australia, in their level of financial literacy and in the level of financial services available in the country from which they have migrated. This heterogeneity means that the range of remittance services available needs to be diverse to cater for this wide variety of needs and that widespread global networks are required if any single provider is to be able to cater for more than a small subset of the market.

While by no means comprehensive, to provide a brief illustration of the varied remittance needs of Australian migrants, it is useful to classify migrants into four broad categories:

- **Permanent migrants:** There are four grounds under which permanent entry is granted into Australia. 1) On family grounds 2) based on the skills possessed by the migrant 3) under Special Eligibility, such as former residents who have maintained ties with Australia and 4) as Refugees.

As shown in Figure 12, Permanent migrants make up slightly less than half of the total annual migrant intake in Australia. With the exception of refugees, who are covered in a separate section below, it could be expected that in general, the financial sophistication of migrants in this category is rather high. Skilled migrants, who make up more than two-thirds of the intake in this category must have a relevant qualification in a skill area targeted by the Australian government and

COUNTRY NAME	2011
China	63.82%
India	35.23%
Korea, Rep.	93.05%
Vietnam	21.37%
Malaysia	66.17%
Thailand	72.67%
Indonesia	19.58%
Nepal	25.31%
Hong Kong SAR, China	88.69%
Saudi Arabia	46.42%

Figure 14: Per cent of Adult Population with a Bank Account (Bank Account Penetration)

Source: World Bank Financial Inclusion Database

migrants applying on family grounds must already have a partner that is a permanent resident in Australia and who can act as their sponsor.¹⁶ Despite this, there are still a number of reasons why this class of migrants would require a variety of different remittance services.

Figure 14, shows bank account penetration rates for a number of countries with high migration rates to Australia. The figure shows that while a migrant may be financially sophisticated, their relatives may lack the financial infrastructure necessary to receive anything other than cash-based remittances. In fact, research by Western Union shows that cash payout is the most attractive payout method for remitters globally.

Box 8 provides further detail on the number of unbanked people globally.

- **Non-permanent migrants:** The Business (Long Stay) Visa (457) is the most common visa used by non-permanent migrants. In 2012, there were 90,900 primary Visa holders in this category¹⁷. Due to the non-permanent nature of 457 Visa holders residence, it would be expected that these migrants are amongst the largest remitters. Figure 15 shows the diverse range of regions from which migrants of this category originate, this is further evidence that a global network and diverse range of products is required to service the remittance needs of Australian migrants.
- **International students:** The other main group of non-permanent visa-holders in Australia is international students. The importance of international students to the Australian economy is considerable (see Figure 16), with education representing Australia's third largest export behind coal and iron ore. It is also interesting to note that the countries representing the largest number of international students in Australia also have relatively

¹⁵ (Salmone, 2006)

¹⁶ Australian Bureau of Statistics, 2009

¹⁷ Department of Immigration and Citizenship, 2012a

BOX 8: SERVICING THE UNBANKED

From the perspective of a country such as Australia in which approximately 99 per cent of the adult population has a bank account it is hard to imagine that more than 600 million people in the East Asia and Pacific region do not own this most basic of financial products.¹⁸

A bank account assists individuals to save, borrow and send and receive remittances. However, distance and lack of money are two reasons precluding many people from using a bank account to assist with these services.

In China almost 40 per cent of people do not own a bank account and 79 per cent of Vietnamese are unbanked. When also considering that around 6 million people from the Pacific Islands are without accounts, the importance of affordable non-account disbursement remittance services in Australia becomes apparent.

Traditionally unbanked migrants have called on traditional MTO cash-to-cash services or informal remittance processes to transfer funds back to their home country. These services allow migrants to transfer funds cross-border with neither party requiring a bank account. Advancements in technology and the telecommunications sector have seen innovations such as M-payments and e-wallets gain momentum as a means of remittances internationally. M-payments and e-wallets are an example of how innovative collaborations across industries are expanding the reach of remittance services, improving access to those in rural areas and creating new business opportunities.

With more than 600 million people in East Asia and the Pacific and almost half the world's population without a bank account, collaboration across industries to find new ways of servicing the remittance needs of these people presents a major social and commercial opportunity.

¹⁸ The World Bank, 2012d

COUNTRIES	2008-09	2009-10	2010-11
China (excludes SARs and Taiwan Province)	3773	4292	4103
India	2855	3066	2012
Korea Republic of (South)	1117	1075	898
Vietnam	594	777	773
Malaysia	814	843	770
Thailand	672	710	607
Indonesia	555	583	559
Nepal	511	606	454
Hong Kong (SAR of China)	560	543	448
Saudi Arabia	288	354	337

Figure 16: Australian Education Exports by Country (AUD Million)

Source: Australian Bureau of Statistics, 2011

low bank account penetration rates, although students are likely to come from families with sufficient income and wealth to imply that they have bank accounts.¹⁹

While it is unlikely that international students would be large senders of remittances, it should be expected that they rely on the receipt of regular remittances from family to cover their cost of living.

- **Refugees:** According to the Department of Immigration and Citizenship, 13,799 refugees were granted visa in 2011.²⁰ This number has been fairly

CITIZENSHIP COUNTRY	PRIMARY APPLICATION	% OF PRIMARY APPLICATION	SECONDARY APPLICATION	% OF SECONDARY APPLICATION	TOTAL APPLICATIONS	% OF TOTAL APPLICATIONS
UNITED KINGDOM	1,500	22.6%	1,200	22.4%	27,00	22.5%
INDIA	1,300	19.6%	1,060	19.9%	2,370	19.8%
IRELAND	620	9.3%	360	6.7%	970	8.1%
PHILIPPINES	500	7.6%	350	6.5%	850	7.1%
UNITED STATES	430	6.5%	300	5.5%	720	6.1%
CHINA	300	4.6%	220	4.0%	520	4.3%
SOUTH AFRICA	120	1.8%	190	3.6%	310	2.6%
KOREA, SOUTH	120	1.8%	150	2.8%	270	2.3%
CANADA	140	2.2%	100	1.8%	240	2.0%
FRANCE	120	1.7%	110	2.1%	230	1.9%
GERMANY	120	1.9%	70	1.3%	200	1.6%
JAPAN	100	1.5%	80	1.5%	180	1.5%
MALAYSIA	100	1.4%	60	1.1%	160	1.3%
NETHERLANDS	70	1.0%	70	1.2%	130	1.1%
NEPAL	70	1.0%	60	1.0%	130	1.0%
OTHER COUNTRIES	1,020	15.4%	970	18.2%	1,990	16.7%
TOTAL	6,620	100.0%	5,340	100.0%	11,960	100.0%

Figure 15: Break down of Business Stay Visas Granted in 2012

Source: Department of Immigration and Citizenship, 2012a

¹⁹ For comparative purposes it is worth noting that according to the World Bank's Financial Inclusion Database, Australia has a bank account penetration rate of 99.1 per cent.

COUNTRIES	NUMBER OF VISAS GRANTED
Iraq	2151
Burma	1443
Afghanistan	1027
Bhutan	1001
Congo (DRC)	565
Ethiopia	381
Sri Lanka	289
Iran	271
Sudan	243
Somalia	190

Figure 17: Offshore Refugee Visa Grants by Top 10 Countries of Birth 2010-11

Source: Department of Immigration and Citizenship, 2012b

COUNTRY NAME	ACCOUNT AT A FORMAL FINANCIAL INSTITUTIONS	ACCOUNT USED TO RECEIVE REMITTANCES
Afghanistan	9.01%	1.73%
Iran, Islamic Rep.	73.68%	27.33%
Sri Lanka	68.53%	5.40%
Iraq	10.55%	1.59%
Congo, Dem. Rep.	3.70%	1.17%
Somalia	31.01%	20.50%

Figure 18: Financial Inclusion in Refugee Countries

Source: Department of Immigration and Citizenship, 2012b

consistent over the last 5 years showing that refugees are becoming an increasingly important part of the Australian community. Figure 17 above shows the birth countries of the greatest number of recent refugee migrants to Australia. As would be expected, many of these refugees come from underdeveloped countries where financial institutions are scarce. As shown in Figure 18, the number of people from these countries that use financial institutions to receive remittances in these countries is in many cases minimal.

The diverse variety of Australian migrants outlined in the preceding section highlight the need and commercial opportunities for remittance service providers to offer fast, efficient, fairly priced and flexible services. An insight into the remitting preferences of a sub-sample of Australian migrants derived from statistics provided by Western Union is provided in Figure 19 above. There is a stark contrast in the preference for using bank account based remittance services by Chinese remitters compared to the preference for cash based transactions of the Indian and Philippine remitters that were surveyed.

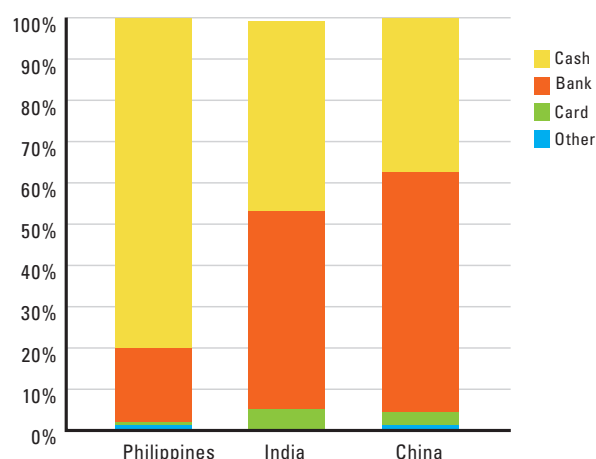


Figure 19: Preferred Remittance Methods: Philippine, Indian and Chinese Migrants

Source: Data supplied by Western Union

The preference for cash-to-cash transactions by many remitters is not dependent upon whether they have a bank account. Virtually all those covered by the survey had access to a bank account. (Figure 20) Three factors seem likely to explain this preference for cash-to-cash transactions in particular corridors. One is the level of financial inclusion and bank account ownership of recipients. A second is the relative speed of cash, relative to account-based, transactions. A third is the relative pricing of the two types of services, with bank account-based services generally being higher than cash based services provided by MTOs.

The relevance of those three factors in determining remittance method choice is reinforced by the fact that the migrants captured in the survey were well educated despite the majority of respondents working in a non-professional capacity. (Figure 21) Low levels of financial literacy among remitters do not appear to be a likely explanation for their preference for cash-to-cash methods.

Figure 22 derived from analysis conducted by McKinsey also suggests that there are significant

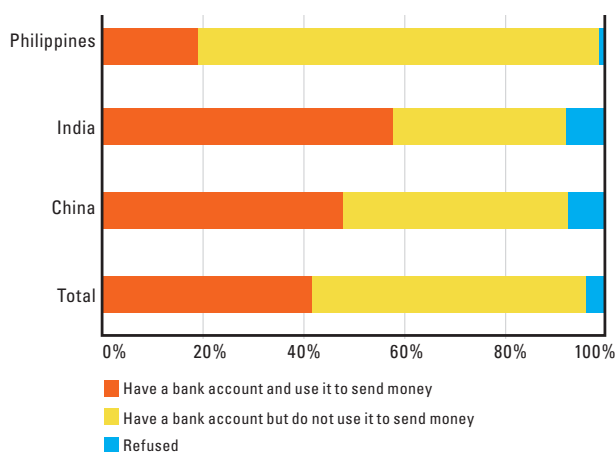


Figure 20: Bank Account Ownership: Australian Migrant Remitters

Source: Data supplied by Western Union

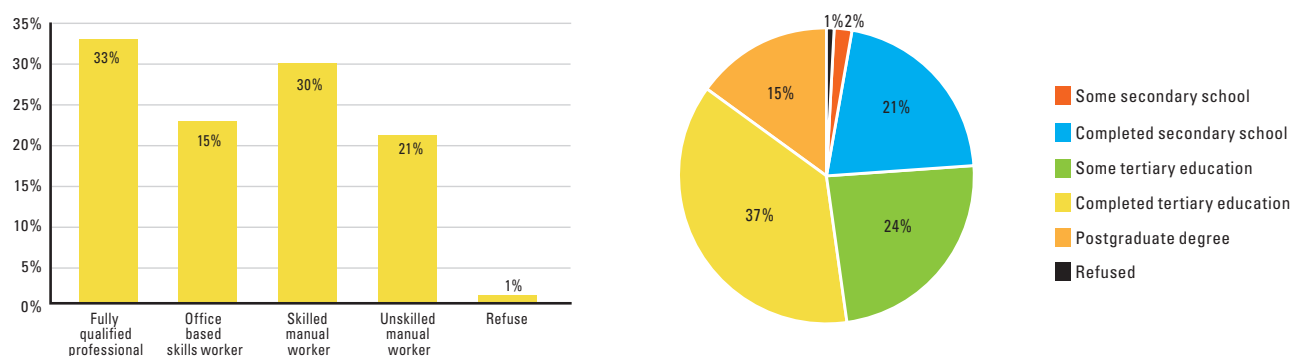


Figure 21: Demographic Information: Migrants Remitting from Australia

Source: Data supplied by Western Union

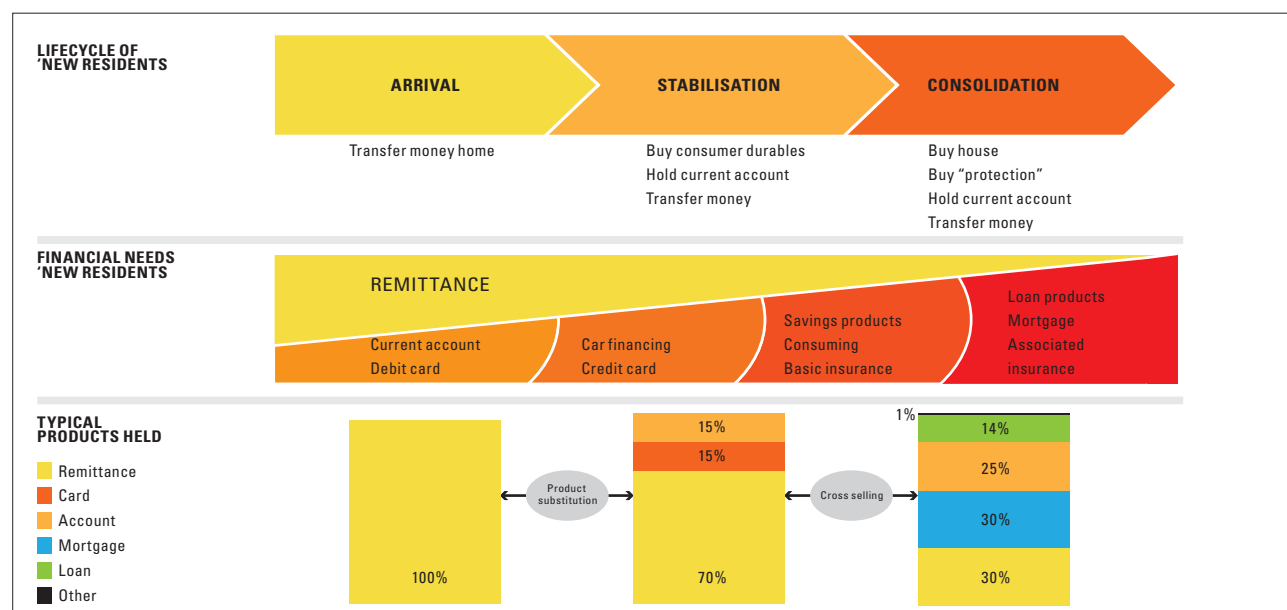


Figure 22: The Migrant Financial Lifecycle

Source: McKinsey Analysis provided to Western Union

cross-promotion opportunities for financial institutions that offer market leading remittance services to migrants and that there may be the potential for financial institutions to offer bundled packages that include cheaper remittance fees for migrant customers.

In addition to migration, another important factor for the future growth of remittances more broadly defined

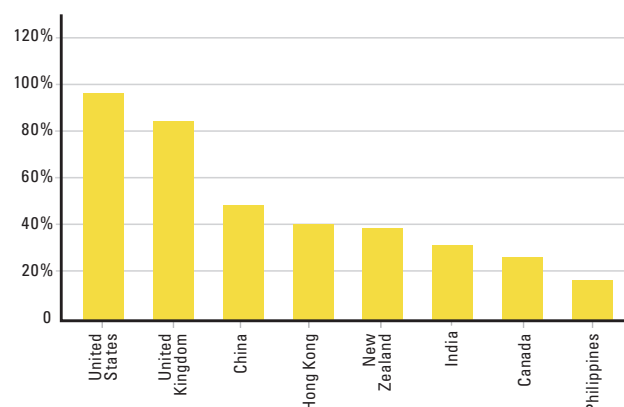


Figure 23: Receiving Countries of Remittance Transfers by Australian Nationals

Source: Data supplied by Western Union

is the growth of retail cross-border spending based on the internet, often involving person to person sales, which provides further opportunities for suppliers of money transfer services. Paypal is perhaps the best known example of a relatively recent successful entrant into this sector, arising from its connection with the online auction and sales site E-Bay.²¹ Many analysts are predicting rapid growth in "e-tailing" with The Economist²² reporting predictions of 10 per cent growth per annum over the next five years in the contribution of the internet to GDP in G20 countries.

This potential is borne out by the reasons for remittance payments made by Australian nationals. Survey data from Western Union indicates the relative importance of payment made to the USA and the UK (see Figure 23) with payments involving both international transfers to family and friends living abroad as well as the transfer of funds to facilitate cross-border purchases of goods and services.

21 Others include Paymate (<http://www.paymate.com/cms/>), POLi (<http://www.polipayments.com/>), and payclick (<https://www.payclick.com.au>)

22 (The Economist Online, 2012)

4.4 THE PRICING AND COST OF REMITTANCES IN AUSTRALIA

Remitting funds is an expensive practice. Globally it is estimated that the average cost of a remittance transaction is 10 percent of the amount sent but this cost can vary greatly depending on the sending and receiving country. Due to the importance of remittance flows to such a large number of underdeveloped countries, lowering the price of remittances has become a priority of the World Bank and many policymakers.

In October 2011, the then Foreign Minister, Kevin Rudd, committed AUD 3.5 million dollars to strategies aimed at reducing the cost of remitting to Pacific Island nations. The strategies cited were increasing price transparency, improving financial literacy and finding innovative approaches to expanding financial services for those outside the banking system. These are strategies also being employed internationally with policies to lower the costs of remittances. Regulatory reform to allow the introduction of new financial products is already being implemented in New Zealand.

Only the latter elements of these strategies (improving financial inclusion and allowing new financial products) are focused upon reducing the underlying costs of providing remittance services by facilitating or permitting use of lower cost techniques. The real resource costs of providing money transfer services for small transactions can be very significant relative to the scale of the transfer when collection, disbursement, currency conversion, and regulatory compliance costs are taken into account. The other strategies, such as increasing price transparency and financial literacy are focused upon increasing the ability of consumers to better assess the prices offered by suppliers and assume that such empowerment of consumers will drive down prices charged. While highly desirable for consumer protection reasons, the expectation that there will be an ultimate effect on prices charged is based upon an unproven assumption that there is inadequate competition in the market for remittance services. In that regard, it is worthy of note that Andreassen²³ found that four of the six highest perceived barriers to entry into the US remittance business were regulatory in nature (with the others being building an agent network and raising working capital).

It is the case that the average cost of remitting from Australia is above the G20 average (and above that charged in New Zealand). According to recent statistics from the World Bank, of the G20 countries, Australia is the third most expensive to send remittances from

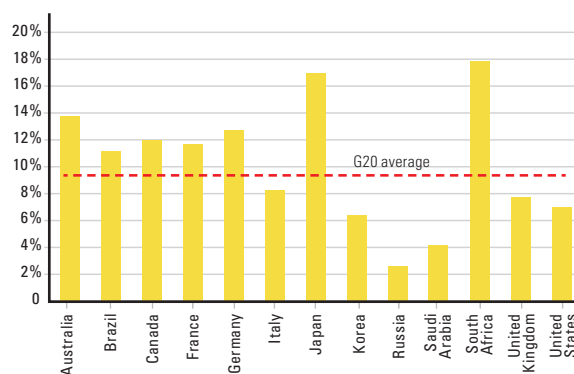


Figure 24: Average Price of Remittance across the G20 Countries, Q3 2011

Source: (The World Bank, 2011b)

with an average remittance cost of approximately 14 per cent. Only Japan and South Africa have a higher average remittance price. (see Figure 24)

Some part of that higher cost seems likely to reflect the country corridors involved and related factors such as the scale of the remittance business (and relative importance of fixed overhead costs), competition, and differences in disbursement options available in the receiving countries. However, those averages hide major variations across the range of service providers and speed and type of service provided. To illustrate, the fees charged by the same provider for a cash to cash, same or next day, transaction were around 3 percentage points higher for transfers from Australia to Pakistan or the Philippines than from the USA, but around 1 – 1.5 percentage points lower for transfers to China and Vietnam²⁴.

Another contributing factor is the nature of the institutions involved. A 2010 report released jointly by the Australian and New Zealand Governments found that remitting through traditional financial institutions was on average 29 per cent more expensive than remitting through an MTO.²⁵ Data from the World Bank Remittance Prices Database for 2012 Quarter 3 indicates that, as a generalisation, this is still the case, although a number of the banks have developed online remittance services for particular countries which have substantially lower fees, but which are generally limited in geographical coverage, and require payment into a bank account, in the receiving country, and involve time lags of several days.

Another important determinant of the cost of a remittance transfer is the destination country of the transfer. At least some part of the high average costs of Australian remittances reflects the relative importance of remittances to Pacific Island countries and the level of financial sector development and coverage in those countries.

²⁴ Calculated using data for 2012 Quarter 3 from <http://remittanceprices.worldbank.org/>

²⁵ (Australian Government & New Zealand Government, 2010)

²³ (Andreassen, 2006)

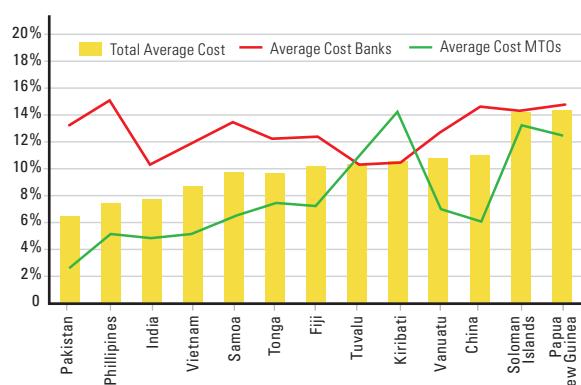


Figure 25: Cost of Remitting AUD 200 from Australia to Selected Countries, 2012: Quarter 3 (latest available figures – in some cases 2011 Quarter 3 data)

Source: World Bank Remittance Price Database

“In the Pacific, there is little interoperability between bank ATM and electronic funds transfer at point of sale (EFTPOS) networks (other than some bilateral arrangements), limiting customer numbers and thereby the financial viability of these networks. In addition, branch and ATM networks are often confined to large population centres, limiting the rural reach of remittances via financial institutions.” (Australian Government & New Zealand Government, 2010, p.8)

A recent report by the United States’ Consumer Financial Protection Bureau found that even in areas with a high number of remittance service providers, remittance costs could be high when sending funds to unusual or rural destinations or to countries with risky business environments.²⁶ While not perfectly correlated, Figure 25 shows a similar trend when looking at different Australian remittance channels. The more popular, less rural channels such as Pakistan, Philippines, India and Vietnam have a much lower average cost than the less serviced Pacific Island countries. It may be expected however, that new payments systems being created by technological innovations will see the costs associated with remitting to more remote locations decline over time. The advent of mobile bank branches, branchless banking, and improving infrastructure is gradually increasing access.

A third factor that contributes to the cost of remittances is the amount of regulation imposed on remittance service providers. Compliance with regulation regarding money laundering and terrorist financing purposes can be costly. A 2006 survey conducted in the US found that costs associated with compliance were four of the six biggest perceived barriers to entry for service providers.

It is important to note that significant progress has been made in reducing the price of remittance payments from Australia in recent years. Figure 26 illustrates

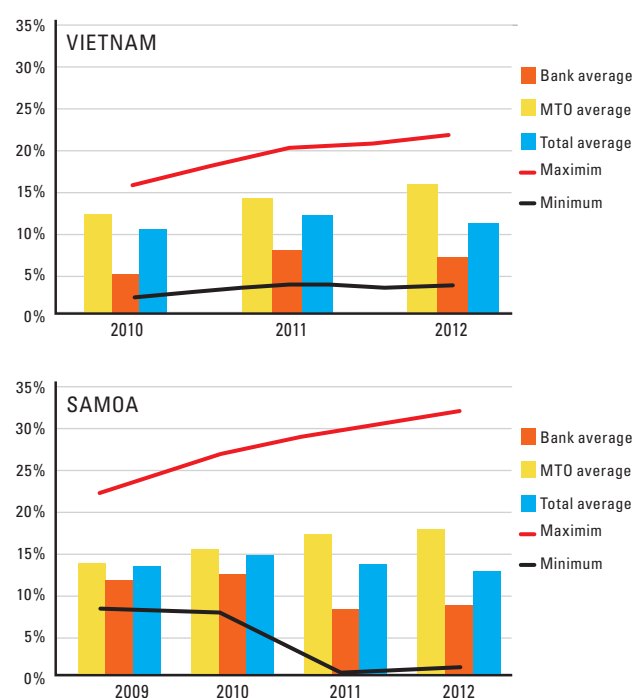


Figure 26: Remittance Cost Developments

Source: World Bank Remittance Price Database

for two receiving countries, Vietnam and Samoa, and also illustrates the difference between bank and MTO average fees and the wide variation in fees. Fees charged by MTOs have declined for both countries. While bank fees appear to have increased over time for both countries, the figure is a simple average over a vast range of types of remittance products involved which have changed over time, and is affected by pricing strategies of individual banks which may involve high prices for some products designed to push users towards more efficient products.

Also noticeable in the case of Samoa is the apparently extremely low fees of one provider reflected in the minimum value since 2011. That product involves the Australian sender transferring funds by an online transaction to the provider who then transfers funds into a bank account of the recipient. Another version of this product involves the provider transferring mobile phone credit to the recipient. The credit received can be used as phone credit or for other phone based transactions or cashed out at an agent of the phone company for a fee. While the cost figures should perhaps be viewed with caution due to possible incomplete information about all costs involved and information on usage not being available, they do indicate the potential for new technologies to lead to significant changes in remittance arrangements. These trends are considered in the next section.

26 (CFPB, 2011)

05 Trends in Remittance Payments Arrangements

Technological change and innovation are driving major, and related, changes in both domestic payments arrangements and in the remittance sector. To appreciate the scope of potential changes it is appropriate to note the options available to an individual when they interact with a payments or money transfer operator to initiate a transaction. Figure 27 illustrates the elements of the transaction involved. Traditional remittance arrangements typically involved individuals presenting cash physically at the branch of a MTO, with similar arrangements for disbursement. For some time, and increasingly so, there are a range of alternative methods available – many of which involve substantial technological fixed costs but very low variable costs per transaction and much increased convenience for users. For example, a MTO may provide facilities that enable an individual to use their home computer to transfer funds from their personal bank account to that of the MTO, and provide payment instructions to initiate the transaction.

As noted by the US Consumer Protection Bureau “... as RTPs [Remittance Transfer Providers] expand beyond cash and account-based transfer products, some are also allowing consumers to initiate transactions by phone, through the Internet, with mobile phone text messages, or at automated stand-alone kiosks. Some RTPs initiate transactions exclusively through technology-based rather than in-person channels.”¹

These developments also have potentially significant implications for the structure of the industry and competitiveness of various types of participants. As the BIS notes “globally active players, such as international card schemes, global mobile operators or internet enterprises, may have the advantage in leveraging their coverage and market power when offering innovative payment solutions across borders, possibly in a flexible manner responding to concrete local needs.”²

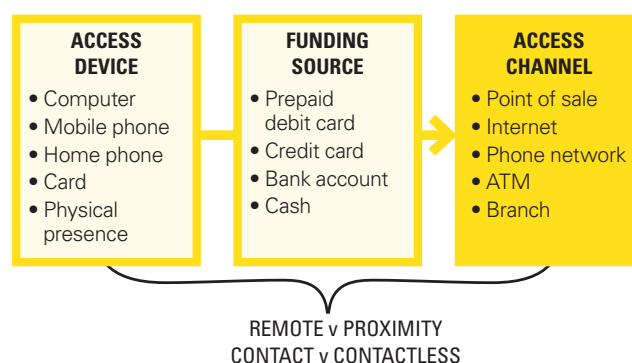


Figure 27: Payments Funding and Access Options

5.1 COMMON REMITTANCE TECHNIQUES

While new remittance systems have gained increasing popularity internationally, cash-to-cash and bank account remittances remain the most popular means of remittances from Australia.³ Figure 28 provides an overview of common remittance techniques, although innovations, prompted by technological change, are occurring constantly. Such innovations have objectives such as reducing identification, documentation and other transaction initiation and completion costs, reducing customer convenience and time costs of interacting with the system, improving the speed and reliability of messaging and settlement systems, enabling individual operators to expand their geographical scope of operations. While many of the innovations are particularly relevant to providing traditional remittance services for payments from developed markets to developing markets where financial inclusion and financial sector development is often relatively low, there is also increasing interest in the provision of payments services for digital (electronic) commerce involving individuals (or other micro-enterprises) at both ends of the transaction.

Figure 29 shows estimates of the difference in average cost to customers of various types of remittance

¹ (CFPB, 2011)

² (Committee on Payment and Settlement Systems & Bank for International Settlements, 2012, p. 50)

³ Derived from market research compiled by Western Union.

REMITTANCE TYPES	DESCRIPTION
Cash-to-Cash (formal)	The sender remits funds by providing cash to a remitter, usually an MTO or retail agent of an MTO, the funds are then disbursed in cash by a corresponding agent in the recipients home country.
Cash-to-Cash (informal)	This method of remittance lends itself the most to avoiding monitoring and regulation. Examples of informal cash-to-cash remittances include: the Hawala system, physically transporting the cash across borders or having a network physically transfer the funds across borders.
Dual Card Model	Two cards are issued with access to the same account.
Card-to-Cash	The sender remits funds via a debit card while the recipient receives the funds in cash, via a bank, MTO or other remitting agent.
Recipient-only card model	The sender purchases a card loaded with funds which is either sent directly to the recipient or issued in the recipient's country. The sender can then reload funds onto the card from their country of residence.
Account-to-Cash	The sender remits funds via an account, usually a bank account and the funds are disbursed in cash via an agent in the recipients' home country.
Account-to-Account	This has been traditionally conducted via bank accounts. However, MTOs like Western Union have begun forming alliances with commercial banks to offer these services. Innovative online service providers such as Klickex in New Zealand have also begun offering low-cost account-to-account services.
Electronic Wallets	The ubiquity of the internet has given rise to a number of online remittance service providers that record a regular user's details to save the user from repeating the input of information. Online remittance services or "E-wallets" are provided by the large commercial banks, large MTOs and specialist providers such as B-Pay. A major advantage of "E-wallets" is that in some cases a user can load funds directly to the online service provider meaning they provide access to many unbanked users.
M-payments systems	A derivative of "e-wallet" technology that has been facilitated by the popularity of smart phones is M-payments systems. M-payments systems are essentially an e-wallet service that allows users to remit money via a mobile phone.

Figure 28: Common Forms of Remittance Services

processes. As can be seen, with the exception of inter-account transfers at the same bank (which are relatively uncommon for international remittances), account based (bank) transfers are significantly more expensive than other forms of remittance arrangements such as those offered by MTOs. The World Bank notes that cash transactions remain the most commonly used, and that "On-line and mobile services do not seem competitive yet in terms of availability and cost."⁴

5.2 ALTERNATIVE TECHNIQUES AND EMERGING TRENDS

"People working in the 'payments space' use that phrase to refer to a new world of retail electronic payment systems – everything from credit cards based

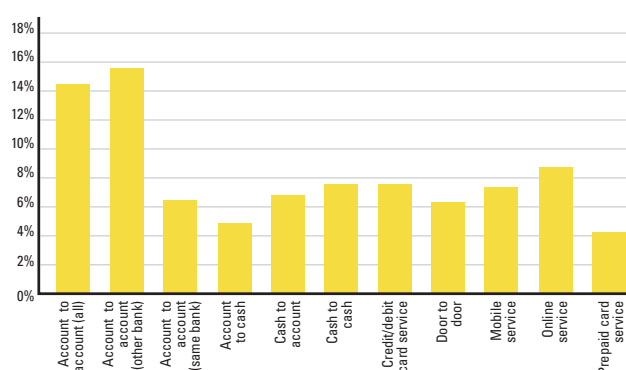


Figure 29: Average Remittance Cost by Product Type

Source: Remittance Prices Worldwide (Issue 3, 2011) the World Bank

4 (The World Bank, 2011b, p. 1)

*on magnetic stripe technology, to radio-frequency ID chips used to store value and/or access a remote account, to mobile phones used in various ways as carriers of money, or airtime minutes, text messages and other things that can be transferred from mobile-to-mobile as a form of currency, to mobile point-of sale terminals reverse-engineered to serve as a channel for banking and financial services"*⁵

There is a wide range of techniques for effecting remittance payments emerging. These also have substantial implications for business models of participating institutions, including potential for cooperative agreements between various types of participants, and for public policy. A few of these techniques are discussed below to convey the flavour of potential developments.

Card based remittances

Use of plastic cards can be used in remittance arrangements in a variety of ways including arrangements where one or both of the sender and receiver make use of a card. The following are non-exhaustive examples of how such arrangements can operate.

- Card-to-cash involves the sender using a card to initiate and fund a transaction with the recipient obtaining cash from the disbursing agent.

5 (The World Bank, 2011b, p. 1)

MODEL:	RECIPIENT ONLY	DUAL CARD	SUB-ACCOUNT WITH LOCAL PARTNER
SENDER FEES	Sender pays shipping fee to purchase and send card	Sender pays typical fees for prepaid card (activation fee, reloading fees and either a monthly maintenance or a transaction fee).	Sender pays typical fees for prepaid card (activation fee, reloading fees and either a monthly maintenance or a transaction fee).
RECIPIENT FEES	Recipient pays a monthly fee and an international ATM fee for each withdrawal	Recipient gets card free but pays international ATM fees to withdrawal funds	Recipient may pay the same to local partner, but will not pay international ATM withdrawal fees
TRANSFER FEES	Sender pays transfer fees to load funds onto the card, which are competitive with existing remittance fees	No transfer fees	Funds transfer through ACH, so would be fairly low fee to sender.

Figure 30: Sample Fee Structures by Card Model

Source: (Orozco et al., 2007)

- Dual card arrangements enable the sender to add funds to an account for their own access by card and for the receiver to also access (subject to imposed limits) via use of a card at an ATM or branch.
- Recipient-only card situations can enable the receiver to access funds in an account at an ATM or branch. Prepaid cards can also be issued to the recipient which can be topped up by the sender from time to time through the provider's network.

While access to funds via ATM in the recipient's country may be feasible (although not always in some developing markets where payments networks are still developing), that may incur costs charged by the ATM owner. International delivery of cards may also be complicated – both for logistical and compliance reasons. Figure 30 outlines some differences in cost and fee arrangements of the various card structures. Orozco et al⁶ also provide figures illustrating the relative cost of card based transactions relative to bank wire transfers (for the US in 2006) which suggest that while the initial card based transaction is slightly more expensive, subsequent transactions are significantly cheaper.

Predicting future trends is always difficult, but it is relevant to note the potential uses of stored value cards, such as those used in a number of urban transit systems. While they have been, generally, limited to a specific purpose (transport fees), there is potential for use to make other payments such as to the accounts of MTOs for initiating remittance payments. While such cards (previously loaded with value by the individual) could be the immediate source of funds to initiate a remittance transaction as well as being the access device, there remain issues associated with efficient access channels as well as the need to incorporate personal information about the sender and receiver into the transaction process.

6 (Orozco, Jacob, & Tescher, 2007)

Mobile Phone Remittance Methods

One of the success stories in innovations in domestic remittances is *M-Pesa* in Kenya, which draws on the widespread use of mobile phones and agents associated with the network provider. Essentially the process involves individuals transferring phone credit from their account to the account of another individual by way of an SMS message. The recipient can then convert that credit into cash through one of the many agents of the phone company, or via traders who act as intermediaries buying credit for cash.

This system has advantages of low cost and minimal customer identification requirements. But it requires the widespread use of a common mobile phone network, or cooperation between network providers, and infrastructure, to enable credit on one system to be converted into credit on another. In the case of international remittances, where there are different national providers of mobile phone networks and foreign exchange currency conversion considerations involved, there are significant impediments to the growth of this remittance technique.

Electronic Wallets

Mobile phones and other electronic devices create the potential for individuals to access payments and remittance services in new ways – such as via “electronic wallets”. These emerging systems (Google Wallet is one example) involve individuals storing relevant personal and financial details securely with a service provider “in the cloud”. Using a mobile phone (or other device) with near field contact capability, a payment or transfer of funds to a merchant or service provider who is linked to the system can be made by placing the device in proximity to the merchant's device. A debit to the individual's specified credit or debit card or account will be initiated, with (if required) the individual verifying the transaction by entering the appropriate password.

Such systems remove the need for use of a physical credit or debit card, potentially enabling individuals to discontinue carrying of actual wallets or purses. The need for time consuming and costly entry of information for each transaction is also removed.

How successful such systems will be remains to be seen, since they require widespread participation by merchants and others in order for individuals to be assured that desired transactions can be effected in this way. They also introduce mobile phone networks and internet service providers into the payments system in a fundamental way, which raises complicated questions about the pattern of future development of, and role of a range of participants in, the payments process.

What role they might play in international remittance services also remains to be seen. They can facilitate the initiation and completion of a remittance transaction, by transfer of funds from the sender's electronic wallet to an MTO's account and subsequently a transfer from the MTO's account to the electronic wallet of the recipient. In principle, such transfers could be undertaken via telephony or the internet, thereby avoiding the need for physical attendance at an MTO office. But it is unclear how long it will be before (or if) such electronic wallets become pervasive among recipients in developing countries (or senders in developed countries) and thus undermine the traditional MTO business model based on widespread branch and agency networks.

06 Public Policy Issues

The remittance industry has been the focus of considerable policy interest worldwide for a number of reasons. One relates to its important role of providing remittance services to individuals, where those services provide both individual benefits but also macro-economic benefits for developing countries which are large receivers. Consequently, there is substantial interest in (a) ensuring that customers understand the nature of the costs involved for consumer protection reasons and (b) reducing the level of costs and fees involved which are viewed as an impediment to higher remittance volumes and which fall upon relatively low income groups. A second reason for focus is that remittance services can help build financial sector capacity and financial inclusion in the developing countries where remittances are received. Finally, there has been concern with the potential for remittance operations to be utilised for money laundering and transfers of funds to terrorist groups, although there is little reason to expect that the risks here for the formal remittance sector are greater than those involved in banking sector transfers (as recent US Government actions against several major banks illustrates). Hence remittance operators have been subject to Anti Money Laundering regulatory requirements.

In line with approaches to other parts of the financial sector by international standard setters, the Bank for International Settlements and the World Bank have developed the set of principles outlined in Figure 31 for remittance policy to achieve the goal of safe and efficient international remittance services.

6.1 FINANCIAL LITERACY, INFORMATION AND COMPETITION

One initiative to increase the transparency of the costs associated with remittances is the World Bank's Remittance Price Database. The database provides a reference for the costs associated with sending

THE GENERAL PRINCIPLES AND RELATED ROLES

The general principles are aimed at the public policy objectives of achieving safe and efficient international remittance services. To this end, the markets for the services should be contestable, transparent, accessible and sound.

Transparency and consumer protection

General Principle 1 The market for remittance services should be transparent and have adequate consumer protection.

Payment system infrastructure

General Principle 2 Improvements to payment system infrastructure that have the potential to increase the efficiency of remittance services should be encouraged.

Legal and regulatory environment

General Principle 3 Remittance services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework in relevant jurisdictions.

Market structure and competition

General Principle 4 Competitive market conditions, including appropriate access to domestic payment infrastructures, should be fostered in the remittance industry.

Governance and risk management

General Principle 5 Remittance services should be supported by appropriate governance and risk management practices.

Roles of remittance service providers and public authorities

A. Role of remittance service providers

Remittance service providers should participate actively in the implementation of the General Principles.

B. Role of public authorities

Public authorities should evaluate what action to take to achieve the public policy objectives through implementation of the General Principles.

Figure 31: General Principles for Remittances

Source: (Committee on Payment and Settlement Systems & Bank for International Settlements, 2012)

remittances from more than 30 countries and 90 receiving countries. The database includes the total explicit fees associated with a remittance transfer as well as any exchange rate spreads. The Remittance Price Database has also inspired the development of five national databases that track the costs of remittances via high volume channels from the databases home country.

The SendMoneyPacific database is a joint initiative of AusAid and the New Zealand Aid Program which provides a database of the cost of remittances from Australia and New Zealand to eight Pacific Island countries. Figure 32 provides a screenshot of the database interface. These initiatives provide consumers with information enabling them to assess the relative cost of alternative suppliers, with objectives of both consumer protection and increasing competition and lowering fees as a result of more empowered consumers. But the extent to which “high” fees reflect market power exploited by service providers or are the result of underlying cost structures, which need to be addressed by other regulatory or legislative changes, is another matter. One such area which is particularly relevant and warranting attention is that of barriers to entry into direct participation in the payments system or opportunities for improved collaboration with participants.

6.2 PAYMENTS SYSTEM POLICY ARRANGEMENTS

MTOs interact with the banking sector which provides the core component of the domestic and international payments systems, providing services which banks have not been able to, or interested in, providing. In many cases, MTOs have established partnerships with banks to their mutual advantage and that of bank customers. But MTOs are excluded from direct participation in the payments systems, and thus have to buy essential services at prices which, if banking sector competition is inadequate, may inflate the cost of providing remittance services.

However, developments in both international and domestic payments system arrangements seem likely to change the nature of relationships and create particular issues for public policy. At the domestic level, the RBA’s strategic review of payments systems¹ notes the potential for development of near-real-time payments processes for retail payments, and the development of technology and systems to enable increased content to be transmitted with payment instructions. Also important is the question of whether interoperability with other systems should extend to enabling payment instructions to identify payees by means other than

bank account numbers, such as mobile phone numbers, and thus facilitation of direct transfers to E-Wallets and other stores of value operated by non-banks. There are significant issues regarding the ability of entities other than banks (such as MTOs and mobile phone network providers) to engage directly with the payments system rather than, as is currently the case, indirectly through banks.

At the international level, the development of SWIFTRemit (see section 4.1 above) is aimed at providing member banks with improved competitive position in the remittances market. Since use of the international payments system (operated via SWIFT) is an essential component of providing international remittance services, the question arises of whether direct participation in the system should be available to MTOs as well as the pricing of accessing the system. Martinez raises the question of whether direct participation in clearing and settlement systems should be permitted as one way of reducing the costs involved in remittance arrangements.²

Also relevant to the future development of retail payments arrangements is the question of interoperability.

A range of closed payments systems have developed where both participants in a transaction must be registered – with PayPal being perhaps the most well-known example. That system relies on transfers of value involving debits from and credits to standard payments instruments – such as credit or debit cards or bank accounts. It thus relies on the existing national payments system.

But also relevant are current and potential developments such as mobile money, expansion of use of stored value cards to facilitate other payments, or growing roles for “virtual currencies” such as on-line gaming and gambling credits, methods of storing and transferring value between participants which can be “cashed out”. These systems can involve transfers of stores of value other than “money” as traditionally defined. To the extent that such stores of value become widely accepted, such that individuals are happy to hold balances of them for future payments and do not feel a need to “cash out” those balances, a “shadow” payments system could emerge alongside the traditional bank based system.

6.3 CONSUMER PROTECTION

As well as the issues involved in protecting individuals from failed transactions (and providing mechanisms for grievances to be pursued) new developments in remittance arrangements introduce other consumer protection issues. In particular, where individuals pre-

1 (Reserve Bank of Australia, 2011)

2 (Martinez, 2005)

OPERATOR	METHOD OF TRANSFER	FEE (AUD)	TOTAL COST (AUD)	TOTAL COST (%)	SAMOAN TALA (WST)S RECEIVED FOR INITIAL AUD200	SPEED OF TRANSFER	OUTLETS
KlickEx – Low Priority	O	0.25	4.05	2.02%	464.02	2-5 business days	Samoan bank account
KlickEx – Priority	O	0.25	6.03	3.01%	459.35	1-3 business days	Samoan bank account
KlickEx – High Priority	O	0.25	9.24	4.62%	451.73	Next day	Samoan bank account
Digicel Mobile Money	O	4.00	10.18	5.09%	449.78	1hr or less	www.digicelmobile.com
Xpress Money	C	12.00	16.05	8.03%	436.16	1hr or less	www.xpressmoney.com
Nikua Money Transfer	C	5.00	19.41	9.70%	428.49	1hr or less	Samoan agent/branch
IMEX Money Transfer	C	10.00	20.81	10.41%	425.60	Same day	Samoan agent and bank branches

Figure 32: The SendMoneyPacific Database: The Cost of Remitting from Australia to Samoa

Source: SendMoneyPacific Database, accessed 2nd July 2012

pay funds into accounts with MTOs, pre-paid cards, or electronic wallets, and use these as a temporary store of value they face the risk of failure of the counterparty and loss of funds. In this regard, these instruments take on some of the characteristics of bank deposits or money – as a store of value and as a means of exchange. How regulatory arrangements should be structured for dealing with this convergence, including for the soliciting of funds as well as for the safeguarding of funds deposited, is an open question.

6.4 MONEY LAUNDERING

Regulation of remittances is important to ensure that remittances are not used to launder money or to fund criminal activities and terrorism. In many countries, to operate legally as a remittance service provider an organisation must record specific information pertaining to all remittance transactions and submit this information to national regulators and/or central banks. In Australia, this means organisations that have been officially lodged on the AUSTRAC Remittance Sector Register and meet AUSTRAC's Anti-money Laundering (AML) and Counter Terrorism Financing (CTF) compliance standards. The informal remittance sector is made up of those providers of remittance services who are not officially registered within their country of operation but essentially operate using a similar process to formal remittance service providers. In India, this process is commonly referred to as the Hawala system but the process has as many names as the countries that use it. Other forms of informal remittance channels include sending cash with people that are travelling to a migrant's home country and sending cash in an envelope via the postal service. As informal providers do not engage in meeting compliance requirements they are able to provide a lower-cost but often higher risk service.

As informal remittance channels do not comply with reporting standards the total value of these flows remain largely uncaptured in the official remittance statistics computed by a country's central bank. The World Bank states that if the remittances sent through informal channels could be estimated, their size could be more than doubled in the official statistics.³ Aside from the measurement problems the informal remittance sector cause for central banks, the inability to track the senders and recipients of informal remittances increases the potential for money laundering and terrorist funding to occur through these channels.

6.5 THE AUSTRALIAN REGULATION OF REMITTANCES

The Australian Government has taken a global leadership position in its response to the perceived risk of remittance transfers with section 6 of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006. One major outcome of this legislation was the requirement for any provider of remittance services to apply through AUSTRAC for inclusion on the Register of Providers of Designated Remittance Services and then re-register every three years.

On the first of November 2011, the Register of Providers of Designated Remittance Services was superseded by the Remittance Sector Register. Inclusion on the register became mandatory from the first November 2011. The Remittance Sector Register makes the distinction between three categories of remittance service providers as outlined in Figure 33.

To enrol for inclusion on the register, a remittance service provider is required to provide information to AUSTRAC regarding their business operations and

³ (Freund & Spatafora, 2005)

1. Remittance network provider:

An organisation that operates a network of remittance affiliates by providing the systems and services that enables its affiliates to provide remittance services

2. Affiliate of remittance network provider:

A business that provides remittance services to customers as part of a remittance network facilitated by a remittance network provider

3. Independent remittance dealer:

A business that provides remittance services to customers using their own systems and processes, independent of a remittance network.

Figure 33: General Principles for Remittances

Source: Australian Transaction Reports and Analysis Centre, 2012a

maintain verifiable transaction records and financial statements.⁴ While the reporting requirements add additional costs to the provision of remittance services particularly toward smaller providers and agents, the

legislation allows for remittance network providers (such as large MTOs) to conduct some of the reporting obligations on behalf of their affiliates (agents).

AUSTRAC reserves the right to determine the suitability of applicants and refuse, suspend or cancel inclusion on the register. The register has also recently been made publicly available via the AUSTRAC website along with all enforceable undertakings and removals from the register. At the time of writing, 13 enforceable undertakings were reported on the AUSTRAC site and two providers had been removed from the register.⁵ The more stringent reporting and registration requirements coupled with the public availability of the register and enforcement of digressions suggest that the Anti-Money Laundering and Counter-Terrorism Financing risks associated with compliant remittance service providers have been significantly reduced as a result of AUSTRAC's actions.

4 Australian Transaction Reports and Analysis Centre, 2012b

5 Australian Transaction Reports and Analysis Centre, 2012c

07 Conclusions

The Remittance Industry is a large and important part of the financial sector worldwide and in Australia. As well as providing valuable services to migrants and temporary guest workers wishing to send funds to relatives overseas (which is the main focus of official Balance of Payments statistics) it facilitates transfers and payments for individuals for a wide variety of reasons. The increasing role of e-commerce and developments in information and communications technology provides both opportunities and challenges for the sector.

Challenges arise because of the potential development of new means of exchange of value such as phone credits, as well as the growing potential for phones and computers as access devices, and access channels such as the internet for initiating and completing transactions. How these will affect the competitiveness of the more traditional business model of MTOs, which involve networks of agents to overcome the costs created by geography and location, remains to be seen. They are likely to be quite significant in countries such as Australia. Developments such as the National Broadband Network enabling improved access to online financial services are likely also to influence future development. But in developing economies, where receipts of migrant remittances are particularly important, less developed financial systems, and restricted access to banking services and electronic networks suggest that changes in business models may progress more slowly.

There are a host of potential challenges arising for financial regulators from mobile phone operators and internet service providers operating in both the domestic and international payments space initially as remittance service providers, and providing “quasi-money” (such as mobile phone credits which may be transferable, acceptable as payment, and built up by individuals as a store of value) which warrant ongoing monitoring.

Improving access to, and reducing the cost of, remittance services in Australia is a worthwhile and important public policy goal. The resulting greater flows of remittances to developing countries can contribute to their social and economic development and welfare – perhaps more effectively than foreign aid or investment. The individuals making remittances from Australia are typically from lower income households, supporting family members in their home countries, such that the cost of remittances, although small dollar amounts, are significant in relation to income levels and amounts sent. The beneficial effects of remittances in alleviating poverty and improving welfare of recipients are well known.

Reflecting these benefits, governments, including in Australia, have committed to goals of reducing remittance costs and impediments to the use of remittance services. The development of price comparison websites is one government initiative aimed at reducing the information gap, but relies on individuals, often with low financial literacy, accessing and understanding the information presented. Since the quality and speed of service, methods of disbursement and thus accessibility for individuals in the receiving country, risks, and other costs can vary markedly across providers, the ability and willingness of individuals to use the information to switch to unfamiliar providers and methods may be questioned. Evaluating the impact of websites such as SendMoneyPacific, with a view to ongoing enhancement is thus an important item for the public policy agenda.

Improving advice about, and accessibility to, remittance services within Australia is also an important goal. It is in this regard that large reputable financial institutions, particularly those with large branch networks, can play an important role. The remittance industry is one largely built on collaboration between a number of agents, each providing specific services in the acquisition,

transmission and distribution phases. In some cases the entire process might be done in-house by one entity, such as account to account transfers between branches of the same bank in different countries. But this serves a very limited range of those seeking to use remittance services – and rarely enables the virtually instantaneous accessibility for recipients provided by the specialist MTOs.

A critical issue in enabling the remittance industry to better fulfil its important economic and social role is thus the ability of MTOs to engage and collaborate with traditional operators of the domestic and international payments systems (ie the banks). As specialists in rapid money transfer built upon their extensive international networks, the MTOs are not direct competitors with banks over most of the banks' service and product range. While the banks operate the international payments system, providing facilities for small, retail,

instantaneous transfers to disparate (often unbanked) parts of the globe is not their comparative advantage.

MTOs have particular skills and business model characteristics in this regard which suggest that cooperation between banks and MTOs seems likely to reduce the costs of providing remittance services to the benefit of both customers and the institutions involved. Bank branch networks and online services can reduce access costs for those wishing to make remittances while providing increased opportunities for banks to develop customer relationships with such individuals, and indirectly or directly provide valuable financial advice. With a high level of ongoing migration (and temporary workers) projected, and involving many from countries where remittances are an important feature of economic and social arrangements, the scope for continued growth of remittances is large.

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ABOUT WESTERN UNION

The Western Union Company (NYSE: WU) is a leader in global payment services.

The company is combining its traditional strengths – a globally recognized brand and a retail presence of 510,000¹ Agent locations in 200 countries and territories - with web, bank accounts, stored value cards and mobile services and cross-border platforms to meet the needs of today's consumers, who require more options across different technologies.

In doing this, Western Union enables greater financial inclusion for up to 2 billion underserved people moving money in minutes² with a choice of 120 currencies.

In 2011, The Western Union Company completed 226 million consumer-to-consumer transactions worldwide, moving \$81 billion of principal between consumers, and 425 million business payments. For more information, visit **www.westernunion.com**

¹ Together with its Vigo, Orlandi Valuta, Pago Facilas as of September 2012

² Funds may be delayed or services unavailable based on certain transaction conditions, including amount sent, destination country, currency availability, regulatory and foreign exchange issues, required receiver action(s), identification requirements, Agent location hours, differences in time zones, or selection of delayed options. Additional Restrictions may apply. See Send form for details.