SUPPLY SIDE CONSTRAINTS for REMITTANCE SERVICE PROVIDERS in the UK

Draft report prepared for Kerry Nelson,
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Contents

List of Tables ... 3

List of Figures ... 4

Glossary and Definitions ... 5

Executive Summary ... 7

Background ... 11

1. Report Objectives & Structure ... 14

2. Methodology ... 15

3. Revenue Streams ... 18

3.1 The Remittance Fee ... 18

3.2 Exchange Rate Spread ... 18

3.3 Bank Charges ... 19

3.4 Float ... 20

4. Fee Pricing – The Characteristics & Determinants of Fees ... 21

5. Costs ... 25

1. Associated Costs ... 26

2. How Costs Vary According to Business Model ... 38

3. How do these costs vary with volumes and with the size of transactions? ... 56

4. How Costs vary between Different Types of MTO and Banks ... 60

5. What is the cost of compliance, risk management, fraud, operations management, etc? ... 64

6. Recommendations ... 70

Bibliography ... 74

APPENDICES ... 75

Appendix 1 – About DMA ... 75

Appendix 2 – MTO questionnaire ... 77

Appendix 3– Regression results ... 82

Appendix 4– PSD Requirements for Small PIs and Authorised PIs ... 83

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List of Tables

Table 1: Cost to Send the Equivalent of USD200 to Key UK Corridors 22

Table 2: An overview of the Different Cost Components & Type... 25

Table 3: Indicative UK Banking Fees 30

Table 4: Cost of DSP Registration in the UK 32

Table 5: Example of £300 sent from UK to Jamaica 41

Table 6: Assumptions for the Agent-to-Agent Model 42

Table 7: Assumptions for Branch-to-Agent 44

Table 8: Assumptions for Remote Ordering Model 46

Table 9: Assumptions for High Volume Agent-to-Agent Model 57

Table 10: Cost Comparison for Staff and Commercial Rent in Key Countries 67

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List of Figures

Figure 1: Money Transfer Flow 39

Figure 2: Agent-to-Agent Flow 40

Figure 3: Breakdown of Revenues for the Agent-to-Agent Model 43

Figure 4: Branch-to-Agent Flow 44

Figure 5: Breakdown of Revenues for Branch-to-Agent 45

Figure 7: Remote Ordering - to -Agent Flow 45

Figure 8: Breakdown of Revenues for Remote Ordering Model 47

Figure 9: Online Operator Flow 49

Figure 10: Bank-to-Bank Flow 52

Figure 11: NRI Account with Barclays 53

Figure 12: Example of Number of Transactions Needed to Break-Even 56

Figure 13: Comparison of Standard and High Volume Agent-to-Agent Model 58

Figure 14: Comparison of Different Cost Components Across Models 60

Figure 15: Comparison of Profits Across Business Models 61

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Glossary and Definitions

AML: Anti-Money Laundering

ATM: Automated Teller Machine

bn: Billion

DfID: Department for International Development (UK Government Department)

DMA: Developing Markets Associates

EEA: European Economic Area

EU: European Union

EUR: Euro (currency)

FSA: Financial Services Authority

FX: Foreign exchange

G8: The Group of Eight (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States).

GNP: Gross National Product

GSMA: Groupe Speciale Mobile Association

HMRC: Her Majesty's Revenue and Customs

IAMTN: International Association of Money Transfer Networks

ID: Identification

IT: Information Technology

KYC: Know Your Customer

MLR: Money Laundering Regulation

MLRO: Money Laundering Reporting Officer

mn: Million

MNO: Money Network Operators

MSB: Money Service Business (any organisation registered as an MSB with HMRC)

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MTO: Money Transfer Operator (any business that sends money overseas for an individual;

including banks, e-money issuers, mobile phone operators and online operators, but excluding banks.

NRI: Non-Resident Indian

PC: Personal Computer

PI: Payment Institution

PPP: Public Private Partnerships

PSD: Payment Services Directive

SAR: Suspicious Activity Report

SWIFT: Society for Worldwide Interbank Financial Telecommunication

UK MTA: United Kingdom Money Transfer Association

UK: United Kingdom

USD: United Sates Dollar (currency)

VAT: Value Added Tax

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Executive Summary

In the G8 Final Declaration on 'Responsible Leadership for a Sustainable Future' (2009) it states:

"*We will work to achieve in particular the objective of a reduction of the global average costs of transferring remittances from the present 10% to 5% in 5 years through enhanced information, transparency, competition and cooperation with partners, generating a significant net increase in income for migrants and their families in the developing world.*"

The "**5x5**" objective adopted by the G8 is a strong step-up in the field of supporting remittances and is to be pursued in partnership with governments, operators and interested stakeholders. It is estimated that by achieving a reduction in remittance prices by 5% in the next 5 years will free up an extra US$12bn.

Despite this ambitious target, very limited work has been undertaken to actually assess the feasibility of this target from the point of view of the money transfer operators (MTOs). Most studies on remittances have focused on the demand side and the use to which remittances are put. However, if prices of remittances are to fall it is essential that the supply-side be examined. In particular it is important to understand the different cost structures of operational models, together with an analysis of those areas that have the biggest impact on MTO costs. With this understanding, policy makers and operators will be able to design more realistic plans to help MTOs operate more effectively and, in time, lead to a reduction in costs.

This paper looks at the supply side constraints of remittance operators in the UK. Given that very little work has been done in this field to date, with none in the UK market, there is no readily available data. For this study, data has been obtained through a mixture of desk based research, questionnaires completed by banks and MTOs, interviews with a representative cross section of operators and the remittance experience of the research team.

Key Findings

Revenues

UK based MTOs have two main revenue streams on each transaction – a **fee** and a **foreign exchange earning**. Despite beliefs to the contrary, there is little or no float income on remittance transactions. Most MTOs tell that they make the majority of their revenue on fees rather than FX. On average, according to the World Bank website remittanceprices.worldbank.org, the average cost (un-weighted) of sending US$200 from the UK is 5.38% to Pakistan, 6.79% to India, 9.28% to Ghana and 11.64% to South Africa.

Operators have revealed that the key determinant of their price setting is the price offered by their competitors. It was noticeable that very few operators adopted a 'cost-plus' pricing model. This approach to pricing was considered essential to maintaining volume in each corridor.

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Costs
Costs to operators vary depending on which operational model is used. The most common model is the **agent based model** where MTOs recruit individual agents or chain businesses to offer their services. Other models include: a **branch model**, where the MTO offers the service from branches they own and are therefore responsible for all of the costs associated; a **remote ordering model** where the customer deals directly with the MTO via a call centre or trades online; and, moving forward, there will be a **mobile phone** option.

There are significant fixed costs associated with running a MTO, and the key areas are: **staff** costs, **rent**, **IT/administrative** costs and, increasingly, **regulatory** costs. The high level of fixed costs means that there is a requirement to drive significant volume through the business which explains the competitive approach to pricing.

The largest variable cost items are agent commissions (in the agent model) which can reach up to 60% of revenue followed, somewhat surprisingly, by **bank charges**. Bank charges are particularly significant and are driven by cash handling charges imposed by banks as this is a highly cash centric business. The level of bank charges can be over £100,000 per year for a medium scale operator driven in part by the lack of competition in the provision of bank accounts to MTOs in the UK.

Costs in Relation to Different Business Models
MTOs The agent model appears to be a particularly expensive way of transacting business. The own-branch model is also expensive but it has the benefit of eliminating commission being paid to a sending agent; although this saving must be offset against the additional staff and rental costs of running a branch.

The remote ordering model, where a consumer either uses the phone or uses the Internet to make a transaction, offers significant savings to operators and has the potential to lead to lower prices. As more remitters open bank accounts and obtain payment cards there are opportunities for them to deal in non-cash methods without the need to visit a location. Provided high volumes can be guaranteed, this has the potential to deliver real savings in operational costs for MTOs.

There has been significant discussion around the potential model for mobile phone based remittances. At the current time there are very few pilots for international mobile payments and therefore it is difficult to derive quantitative data in this area. However, if mobile payments solutions include an e-wallet there will be opportunity for additional cost savings to be made. This method has the potential to deliver a major shift in the pricing of remittances but caution must be exercised as, if the model merely duplicates the existing agent model and uses the same charging basis, then there will be negligible cost savings.

Banks The bank account-to-bank account model is currently a highly manual process in most banks in the UK and is only offered to a bank's own customers. A remittance is processed in exactly the same way as any international payment via a bank. This means that unless the user's account type allows them to carry international payments telephonically or online, a consumer has to physically visit a branch and then there are at least two manual checks in processing the transaction. Whilst the actual

transmission cost via SWIFT is negligible, the highly labour intensive element in the client process means that banks do not currently compete effectively in the remittances market.

Costs in Relation to Volume

Marginal costs reduce as volumes increase in the remittances business due to economies of scale and the opportunity for the batching and netting of funds. This therefore puts the imperative on driving volume for each remittances company.

Costs in Relation to Regulation and Compliance

One of the key areas for all MTOs and banks is regulation and compliance. There has been significant debate as to the cost of this activity and it was of interest that most operators felt that either the current regulatory requirements were appropriate or that they were a 'necessary evil' that they needed to meet and that therefore there was an acceptance of the current environment. The costs involved in compliance appear to be between 2 and 10% of total operational costs for most businesses although concern was expressed that for many this was the fastest growing area of their expense base in terms of regulatory fees (particularly with the introduction of the PSD) and a growth in staff numbers within compliance teams.

The UK appears to have a slightly higher set of underlying costs than other markets in Europe and the USA although it will require a similar study to be conducted in those markets for a true comparison to be made.

Conclusions

1) UK based money transfer businesses are not very profitable for many UK based operators.
2) The agent business model that is currently used is inherently expensive as much of the revenue (up to 60%) is provided to the agents.
3) The bank account to bank account model is extremely expensive largely due to high labour costs and inefficient processes.
4) The largest cost area for operators is the staff that they employ.
5) The second largest cost area is bank charges – these are running at over £100,000 p.a. for some medium sized operators. This is largely driven by the high cash handling charges (50p per £100) and high account fees. This is not helped by a market where one bank provides services to over 75% of operators because some of the other banks will not operate bank accounts for MSBs.
6) The cost of compliance and regulation does not appear to be a major item on companies' bottom lines but it should not be ignored. The cost is somewhere between 2 and 10% of total revenue depending on the business.
7) Models that do not need agents, e.g. internet services, are inherently much cheaper and a greater adoption would bring down overall costs. This will require a change in customer behaviour and would benefit from some help to the industry to introduce new products.

8) Mobile phones could provide a more cost effective solution depending on how customers put money into the system. In many ways this could deliver the same sort of cost savings as the Internet. It would have the added advantage that if it is used on the receive-side, it could lead to a further reduction in costs.

Recommendations

For Money Transfer Operators

1) MTOs and banks should explore options to adapt business models and remove/reduce the reliance on agents and pass on costs to consumers.

2) MTOs and banks should try to automate their systems.

3) MTOs should consider diversification of products and services in order to leverage off the investment they have made in their existing infrastructure.

For Banks and the FSA

4) More encouragement should be given to banks to offer more competitive banking services to MTOs

5) Authorised MTOs under the PSD, given their lesser level of perceived risk, should be able to negotiate reduced bank costs.

6) Better monitoring of MTOs and enforcement of the regulations should be implemented to generate a level playing field.

For the Public Sector

7) There is a need to educate the Diasporas in the UK about new transfer methods.

8) Educate the UK based Diasporas about the benefits of the PSD.

9) Work with recipient country governments to improve their financial infrastructure and regulatory approach.

10) Encourage greater harmonisation of regulation internationally.

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Background

"Reducing the cost of personal remittances is the most promising area of policy intervention for several reasons. First, it will stanch a drain on resources of poor migrants and their families back home. Second, it will increase flows through formal channels, especially banks. Third, it will improve financial access for the poor in developing countries".

Global Economic Prospects 2005 (p.135)

Some 200 million people live and work away from their countries of origin. The money that they send home to their friends and families is vital to developing countries and a crucial source of foreign exchange for them. The World Bank estimates that global remittances to developing countries are $338 billion[1] through official channels and that, until the credit crunch, they were growing by more than 10% per annum. Remittances are larger than aid flows and almost as large as foreign direct investment. For 12 poor countries, remittance inflows exceed 20% of GNP.

The use of formal channels plays a role in alleviating foreign exchange constraints and supporting balance of payments. Furthermore, the greater stability of remittances compared to other capital flows, contributes to the stability of the recipient economies by compensating for foreign exchange losses due to macroeconomic shocks. Remittance flows can also allow financial institutions to improve their liquidity and expand their lending operations if clients deposit their remittances. Furthermore, it can allow them to gain access to hard foreign currency at advantageous rates, earn fee income and cross sell additional financial services.

At the micro level, remittances play a significant role in reducing poverty. Beneficiaries are likely to spend the money they receive on health, education, food, consumer goods and establishing small businesses. There is evidence[2] that households receiving remittances have higher nutrition and health status, better educational levels and have pools of money available for emergencies.

UK remittances outflows were estimated to be £4.1 billion in 2008[3], though alternative sources of information produce somewhat different figures. About one third of the 4.5 million people from minority ethnic groups in the UK are thought likely to send money home. The DFID survey in 2005 estimated that the median amount sent was £324, with 3.5 transactions a year. The main corridors are to the Indian sub-Continent, sub-Saharan Africa and the Caribbean. Transfers to Eastern Europe, particularly to Poland, have grown rapidly in the past decade.

The General Principles developed by the World Bank and the Bank for International Settlements published in 2007 identify five challenges:

- Remittance markets should be transparent and have adequate consumer protection.
- Improvements to payment systems infrastructures should increase the efficiency of remittance services.

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[1] Source: World Bank Migration and Remittance Trends 2009 – November 2009
[2] Source: World Bank
[3] Source: Office of National Statistics, United Kingdom

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- There should be a sound, predictable, non-discriminatory and proportionate legal and regulatory framework.
- Markets should be competitive.
- Appropriate governance and risk management practices should be in place.

For consumers of remittance services, both senders and receivers, the requirement is for services which are fast, convenient, reliable and good value. All of these attributes will be encouraged by compliance with the General Principles.

Although speed, convenience and reliability will remain important factors, it is the cost of sending remittances that is currently the focus of much international attention.

Global Initiatives

The G8 meeting in June 2009 reaffirmed the importance of remittances in reducing poverty in developing countries. The G8 leaders adopted a target of cutting the costs of sending remittances by 5% points in 5 years. If achieved, this will put much needed funds into the pockets of recipients and provide additional foreign exchange for developing countries. It is estimated that this could make an impact of over USD12 billion. To support this, the G8 has established a global remittances working group which is composed of remittances experts from across the globe and has identified four main work streams. In addition to this a Private Public Partnership (PPP) group has been formed with representatives of the key stakeholders, including industry, regulators and multi-lateral organisations. The PPP group acts as a conduit to address many of the factors that influence the efficient functioning of the international remittances market.

Whilst the prices of sending remittances from the UK have come down over the last five years, they remain at about the same level as the global average. According to the World Bank website remittanceprices.worldbank.org, the average cost (unweighted) of sending US$200 from the UK is 5.38% to Pakistan, 6.79% to India, 9.28% to Ghana and 11.64% to South Africa. Other corridors such as the USA to Latin America and Russia to CIS countries are much cheaper.

The key question is why are prices at the level that they are in the UK? Given that entry barriers are lower than in many other markets, the number of active MTOs – some 2800 – exceeds that of any other European country and that a number of measures to make the market more transparent and consumers better informed have gone further than elsewhere it would be expected that prices would be lower.

In the UK, measures supported by DFID to reduce costs, have so far concentrated on **demand-side** issues, including:

- Price comparison websites
- The Remittances Customer Charter
- Promoting transparency in pricing, and
- Ensuring that consumers are better informed.

This paper, however, is directed at **supply-side** issues and looks to understand the cost that operators incur in each of the different operating models. The paper seeks to find ways in which operational costs could be reduced, with the expectation that this will lead in due course to lower prices for consumers. It builds on existing World Bank supply-side initiatives, which include:

- Improving the legal and regulatory environment in which MTOs operate,
- Removing exclusivity clauses in contracts, and
- Removing barriers to entry to national payment systems.

The way to reduce prices may lie, at least in part, with the cost structure involved in sending remittances. This is, no doubt, an issue to which individual MTOs devote much attention, but it does not appear to have been addressed or understood at a national or international level. It is anticipated that the results of this UK study will have relevance in other countries.

1. Report Objectives & Structure

The project brief was addressed to find solutions to the following:

- What is the cost of compliance, risk management, fraud, operations management, etc?
- How do these costs vary with volumes and with the size of transactions?
- How do costs vary between different types of MTO and banks?
- How is changing technology and regulation impacting the cost model?
- How do the main cost components in the UK compare with other leading countries?

This report includes information on the following:

- An overview of the most common traditional and emerging business models
- A description of the end-to-end value chain for each, along with indicative costs
- An indication of which costs are fixed and which are variable
- Specifically, a view on the extent to which regulation is increasing costs

Report Structure

In Section 2 a description of the sample and methodology are provided. In Section 3 the different sources of revenue for both MTOs and banks in providing international money transfer services are identified. Section 4 is a literature review, looking at how fees are priced internationally and, what determines the costs of transfers at an international cross-country level is presented.

In Section 5.1 all the different cost components (both variable and fixed) that can be encountered through the money transfer process are identified. Section 5.2 how these costs vary according to different business models is examined. End-to-end value chains and illustrative models are created to indicate the main cost components, where they feature and the relative margins for profit.

In Sections 5.3 to 5.5, drawing on the information presented so far, is the analysis which includes a comparative study of the different business models and the impact of new technologies; the effects of high volumes and large transaction size on costs; and the impact and cost of UK regulation.

Finally, in Section 6, based on the findings of the study, the recommendations are presented.

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2. Methodology

Desktop Study

A desktop study of all research and work already undertaken in this field was completed. Extensive research showed limited studies on this topic to date. Research had either been conducted by the World Bank in 2005, including Ratha and Riedberg (2005a) and Kalan and Aykut (2005b), (based on US data for some of the world's largest MTOs) or cross-country regression analysis, such as Freud and Spatafora (2005c) and Beck and Martinez (2009) looking at the determinants of remittance fees across countries.

Some of the high-level research findings are presented in Section 5, others have been used to validate and substantiate findings from the UK market, especially where information is missing and not available.

Companies' Financial Statements

An analysis of companies' financial statements was obtained from Companies House and from publicly quoted companies where these were available. Whilst all English and Welsh limited companies are required to register their annual accounts with Companies House, the level of detail that is required is often quite limited. Therefore the quality of information obtained in this way varied dramatically by operator.

Questionnaire

A questionnaire was sent to a number of MTOs operating in the UK (see Appendix 1). This methodology produced a high level of useful responses.

Meetings

Information was gathered from a series of in-depth meetings with MTOs and banks operating in the UK market.

It should be noted that, given its commercially sensitive nature, the information from companies was provided on the basis that it is confidential and non-attributable.

The Sample

Every effort was made to ensure that the sample was as representative of the true population in the UK as possible, including:

a. Businesses offering different methods of transfer; including
    i. agent-agent
    ii. bank-bank

iii. electronic
iv. online
v. payment cards
vi. banks etc

b. Different types of organisations; including
   i. Single corridor
   ii. Multi-corridors
   iii. International – multi send and receive corridors

c. Different sized organisations;
   i. Small (average monthly payment transactions (over the preceding 12 months) < €3million)
   ii. Large (average monthly payment transactions > €3million)

d. Both well established businesses and new market entrants

e. Trade bodies representing the money transfer industry in the UK and globally

REVENUES & COSTS

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In order to be able to analyse and understand the cost structures and supply-side constraints of MTOs and banks operating money transfer services in the UK, it is fundamental to understand where they receive their revenues. This will allow for comparative analysis of costs in the following sections as costs will be analysed in relation to revenue.

The main ways in which MTOs and banks can earn revenue are outlined below.

3. Revenue Streams

3.1 The Remittance Fee

The fee is collected from the sender by the sending agent in return for receiving, processing and arranging for the paying out the transfer. It is a legal requirement that this fee is made publicly available to the sender prior to committing to the transfer.

For most MTOs as the send amount increases the proportion charged as a fee by the MTO decreases. This is usually because many organisations have a banded fee structure (e.g. x to send between £1 and £100, y to send between £101 and £200, etc.). Within this there is ultimately a maximum fee for any amount.

According to MTOs operating in the UK the fee charged to the senders is usually a function of:

1. The fees charged by competitors for similar services

In recent years, even market leaders that had traditionally been price setters have been forced to lower their prices in response to new competitors in the market driving down prices. This is indicative of a competitive market; where there are profits to be made new players have entered the market and driven down prices thus reducing the potential for profit for all.

2. Internal cost structures

The internal cost structure will depend on the:

a. The type of transfer
b. The country the money is being sent to
c. The speed with which the money should be delivered

3.2 Exchange Rate Spread

The foreign exchange fee is the difference between the retail foreign exchange rate that the MTO charges the sender and the more favourable wholesale foreign exchange rate that the MTO actually pays. The difference in the rates (the spread) is not usually readily available to the sender although the actual retail FX rate must be supplied to the sender.

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For most MTOs, including banks, the foreign exchange rate is set once a day and is generally a standard margin per country. This will be set in relation to the volatility of the foreign exchange rate in relation to the domestic currency as well as how competitive the rate is for the consumer compared to other operators. Websites such as www.moneymove.org continue to bring more transparency to the market by providing customers with price comparisons, including exchange rate costs, between retailers.

The foreign exchange spread is not only a revenue generating mechanism, but can cover the time delay that MTOs often experience in paying the recipient and actually settling the foreign exchange balance. The foreign exchange spread therefore covers for the risk that in the interim period the exchange rate will have moved unfavourably against the exchange rate provided at the point of sale. Therefore, currencies which experience a high level of volatility and are generally unstable are likely to have a higher foreign exchange spread.

MTOs adopt different hedging strategies to manage their exposures to different currencies. Some currencies are covered totally on a matched basis where the MTO buys the exact amount of foreign currency that it is selling to a customer. Others will buy parcels of foreign currency based on their experience of market volumes. There are risks and rewards with each of them but when managed correctly foreign exchange profit is one of the key revenue drivers.

3.3 Bank Charges

For banks there are two revenue streams that are derived from remittances. The first is where they act as an MTO and send remittances or international payments for their customers. These charges should be looked at as the equivalent of fee income for the MTOs. Banks in the UK generally transfer funds on an account-to-account basis only. A customer sending by this method has a choice of three charging conventions:

1. Ours = The sender pays the bank charges of both the sending and receiving banks
2. Share = The sender pays the charges of the sending bank and the receiver pays the charges of the receiving bank
3. Ben = The receiver pays both send and receive bank charges

It is assumed that in the case of money transfer, senders will normally adopt ‘ours’ and pay the bank charges at both ends of the transaction. In practice, each bank is free to set its own bank charges. Therefore, if using the ‘ours’ charging basis, in order to make sure that the UK sender covers the total costs, the UK bank estimates the charges that the overseas bank will levy and passes this on to the sender. The bank will therefore bear the cost of it if they have underestimated the actual overseas bank charge, but will also reap the reward should they have overestimated it. If the sender has been overcharged the foreign bank’s actual charges, they are able to complain to the bank and be compensated accordingly although this is a difficult process.

Later in this report (Section 5.1), the second area of income for banks - bank charges are also identified as a significant cost to non-bank operators and therefore are a revenue stream for banks. However, as these charges are for normal banking facilities they are not considered a remittances related revenue stream for banks.

3.4 Float

It is often thought that remittance payment products have the potential to earn 'float income' as interest could be earned on the timing difference between when the money is paid by the sender and paid out to the receiver. However, the reality is that many remittances are collected on the same day (or the following one) that they are sent. Indeed, under an agent model where the agent often pays the MTO on the day after sending the money the MTO can actually be managing a negative float position. Therefore there is little or no float income.

In addition, all authorised PIs (Payment Institutions) are required to safeguard funds that have been collected from senders, in a specific account, until the money has been collected. Often this will result in the MTO tying up working capital on which no return is earned.

Whilst the composition of revenue generation for banks is not available, it is known that the 'float' is a revenue generator for banks. It has been suggested, that the float is in fact a key source of revenue for some banks; especially those that purposefully delay the transfer process to make more interest on the float.

Summary

The main revenue drivers for a money transfer business are fees and FX. There is minimal float income from offering remittances.

Interestingly, a number of operators advised that their pricing is solely determined by the competitive state of the market and is not driven by a 'cost plus' model.

4. Fee Pricing – The Characteristics & Determinants of Fees

"Remittances are differentiated by a number of characteristics that make them special: origin and destination, speed of service, security of transfer and the general customer experience both when sending and receiving the funds"

(Ratha & Riedberg (2005a) p.17).

Kalan and Aykut (2005b) look at the largest MTOs operating globally to check for fee pricing consistency on a number of different variables. They look at 53 corridors and through their examples they show that remittance fee pricing is both complex and non-uniform. They show that:

- Remittance fee pricing varies significantly by competitor, corridor and channel.
- Major fee pricing differences can also be observed between different sending countries – even for the same competitors, sending remittances to the same receiving countries.
- Fees also vary with the size of the remittance.
- Fees can also vary significantly for a single competitor by type of service offered, sending city, and individual sending agent

With so many different variables affecting fee prices in the market it makes it difficult to benchmark UK prices against foreign country prices. In the table below an average price across operators is calculated for UK to foreign country corridors. The high level of disparity between the total cost paid by the sender is evident from the table. Data in the table is compiled by the World Bank and estimates the cost of sending $200 from the UK.[4]

[4] It should be noted that the methodology used to gather this data was defined by the World Bank as part of a consistent approach which allows for cross-country comparison. This explains why the USD is used as the currency unit.

TABLE 1: COST TO SEND THE EQUIVALENT OF USD200 TO KEY UK CORRIDORS

			Average total cost (Q3 2009)	
Receiving country	Fee	Exchange rate margin (%)	Percent (%)	USD ($)
Pakistan	7.18	1.79	5.38	10.76
Brazil	3.48	4.52	6.26	12.52
Poland	8.82	1.74	6.45	12.89
Bangladesh	9.65	1.86	6.69	13.37
India	9.60	1.74	6.79	13.59
Sri Lanka	9.80	1.90	6.8	13.60
Nepal	8.69	2.51	6.85	13.70
Philippines	12.77	1.88	8.48	16.96
Lithuania	11.32	3.21	9.25	18.50
Ghana	12.29	3.14	9.28	18.57
Bulgaria	12.09	3.10	9.57	19.14
Romania	12.91	2.81	9.69	19.38
Nigeria	15.78	1.82	9.71	19.42
Jamaica	13.43	3.24	9.95	19.91
Albania	12.54	3.63	10.33	20.65
Uganda	12.35	4.21	10.39	20.78
South Africa	14.28	4.50	11.64	23.28
Kenya	13.92	4.88	11.84	23.68
Sierra Leone	12.56	5.76	12.04	24.08
Zambia	24.98	1.60	14.09	28.17
China	20.29	2.58	14.14	28.27
Rwanda	25.50	1.17	14.55	29.11

Source: World Bank Remittance Website

In support of the Kalan and Aykut (2005b) results it is found that UK fee prices vary considerably depending on the specifics of the service and corridor. The most common determinants of fee prices according to the MTOs surveyed are:

- Volume in the Corridor (more volume; lower costs)
- Costs in the foreign country (higher costs; higher costs)
- Compliance costs in foreign country (high bureaucracy; high costs)
- Exchange rate volatility in foreign country (volatile; high costs)

Cost of agents in the UK market (high costs; high costs)Different MTOs rated some of the above factors as more important than others. There is no direct relation between the type or size of operator and how they determine their fee pricing.

All MTOs are required to be totally transparent with their fees and FX rate (although they do not declare their FX margin). In competitive markets, customers are willing to search for the most competitive rates and this includes the foreign exchange rate on offer. In some corridors, such as the

UK-Ghana the exchange rate is set by the Central Bank and operators are not allowed to sell at a different one.[5]

Nearly all MTOs operating the traditional model claim to make the majority of their revenue through the fees charged to customers. Conversely, some online operators make nearly all their revenue through the foreign exchange spread which enables them to offer money transfers for no fee.

Below, the results from cross-country regression analysis on what are the main determinants of costs internationally are examined. Discrepancies in the results indicate that there is no fixed relationship across all MTOs internationally on how costs are determined at a macro level.

In 2005 Freud and Spatafora published a paper on transaction costs, determinants, and informal flows in remittances. Using data from 104 countries over the period 1995-2003 they run a cross-sectional regression to test the impact on costs of:

- transaction costs associated with receiving remittances (2005 values);
- bank concentration;
- financial development, as measured by the ratio of domestic deposits to GDP;
- financial risk;
- dollarisation; and
- domestic output per capita.

The results (see Appendix III) showed that a high bank concentration and high financial risk makes costs more expensive, whereas a high level of financial development, dollarisation and a high level of domestic output drives down costs.

Overall, the results suggest that a wide range of policies (including measures to increase competition among remittance service providers, to increase financial development, and to reduce exchange rate volatility) would be expected to reduce the transaction costs associated with remittances, and hence to increase recorded remittances.

In 2009, Beck and Martinez Peria conducted a cross-country regression analysis on 119 corridors, including 13 send-countries and 60 receive to try and empirically show what determines the cost of remittances. They look at 8-10 major service providers including both MTOs and banks active in the market. They estimate proxies for the explanatory variables. Their results show that:

[5] It should be noted that in the Ghana corridor not all operators follow this requirement.

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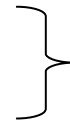
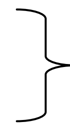
- Higher income levels in the send and receive country
- Greater bank participation in the remittance market
- Higher share of rural population



Higher average remittance costs

And that:

- Higher number of migrants
- Higher number of market players
- Greater bank competition in the receive country



Lower average remittance costs

Exchange rate volatility, capital controls and regulation were found to have no impact on cost of remittances.

The discrepancies between the two models in terms of domestic income, exchange rate volatility and bank concentration indicates the sensitivity of results to the samples and proxies they use and further than that indicates that the determinants of costs to consumers are not standard across countries and are determined on a micro / individual basis. In other words there are few discernable patterns to determining the cost of remittances.

In the following section the different cost components of MTOs and banks operating in the UK money transfer market are identified and their determinants analysed on an individual basis.

5. Costs

This section details the main cost components experienced by MTOs and banks operating in the UK remittance market. Some of the costs incurred are variable, which means that they are only incurred when a transfer is made, whilst others are fixed costs which means that they do not vary directly with the number of transactions. In reality, however, the distinction between variable and fixed costs is not as clear cut. Clearly, as the number of transactions increases and the size of the business grows, so too will the number of staff that are required for processing, the space needed for staff, marketing and administrative costs etc. In the case of the IT, telecommunications technology costs certain components are likely to be variable, such as telephone bills, whereas other components such as software development are likely to be fixed.

Not all accounting methods treat specific items in a standardised manner in terms of where they are categorised and therefore there can be discrepancies between financial statements of different companies. Furthermore, many of the MTOs analysed provide a range of different products and services across a number of different countries; therefore their consolidated financial statements were not useful in the analysis. Not all of the costs outlined here are experienced by each of the different types of business models.

In Section 5.2 the costs incurred in different business models at different points of the end-to-end process will be identified. Table 2 gives an overview of the different costs that can be incurred by money transfer businesses and indicates whether the cost is fixed or variable. This is followed by a detailed explanation of each cost type.

Costs		Type
Send Agent Fees		Variable
Receive Agent Fees		Variable
Bank Costs	Cost of Having a Bank Account	Fixed
	Bank Charges	Variable
	SWIFT	Variable
	VISA / MAsterCard / Maestro	Variable
Regulation	Small PI	Fixed
	Authorised PI	Fixed
	ID Requirements	Fixed
Staff		Fixed
Marketing		Fixed
Administrative Costs		Fixed
Rent		Fixed
IT / Telecommunications /Technology Costs		Fixed
Foreign Exchange Costs		Variable
Professional Fees		Fixed
Security Costs		Fixed
Opportunity Costs		Variable

TABLE 2: AN OVERVIEW OF THE DIFFERENT COST COMPONENTS & TYPE

1. Associated Costs

i. **Send Agents**	**Variable**

Agent costs are a variable cost which means that they are incurred only when a transaction takes place.

Agent's fees are typically a share of the remittance fee and in some cases the foreign exchange (FX) earning as well. Agent's fees in the UK vary according to the different operators and can range from as much as 50% of the total fee charged to as little as 15%.

Some large MTOs utilise existing networks such as the Post Office or travel agents. Others tend to out-source their agent management to Master or Super Agents that manage a network of agents on their behalf. Smaller MTOs source and manage their networks directly. For many MTOs agents are often existing shops, such as local convenience and grocery stores that are situated in areas with large Diasporas.

Depending on the MTO the agent's fee is either standardised across all agents or varies depending on negotiations between the MTO and the agent.

Master Agents

There are only a few Master (or Super) Agents operating in the UK at present. Examples of these are GAP, Finint, Angelo Costa and Fexco for Western Union and N&N (part of Provident Financial) and PayPoint for MoneyGram. The Master Agent takes the responsibility of recruiting, co-ordinating and managing the agent network on behalf of the MTO. The Master Agent is responsible for paying the agents and for settling the bank fees.
MTOs and Master Agents negotiate their payment terms in a similar manner to negotiations with direct agents.

Often Master Agents operate in complementary business, e.g. cheque casher and are able to use the flows of cash from remittances to reduce their cash handling fees with the banks.

It is typically the larger MTOs that employ a Master Agent as the incremental additional commission they must pay is offset by the reduction in operational and regulatory costs to MTOs.

The agent's location is found to be the main determinant of fees; where agents located in more desirable areas (for money transfers), with better premises and higher visibility (that are likely to process more transactions) negotiate higher fees. Similarly in highly competitive corridors where transfer volumes are large and there is stiff competition for agents the fees agents can demand is driven upward. Whereas most MTOs try to pay agents a competitive rate relative to the market, a few smaller MTOs chose to pay above the market rate to ensure that agents are loyal and incentivise them to use their services to process transactions as opposed to another MTO. Many agents in the UK now offer multiple remittance services. Smaller MTOs have accepted this trend and tend to not have exclusivity deals with the agents, but some of the larger international MTOs still require this.

For some smaller MTOs operating in competitive high volume corridors, agents have been able to demand as much as 50% of the fee plus a share of the FX earning.

In summary, whilst the MTO has ultimate sanction on what level of commission is paid to agents the UK market has changed in the last three years to a situation where agents have more power and therefore there is pressure on MTOs to increase commission levels.

ii. Receive Agents	Variable

Agent costs in the receive country are also a variable cost which means that they are incurred only when a transaction takes place. The agent's fee in the receive country also tends to be a proportion of the fee and the foreign exchange (FX) earnings. Understanding the fees paid to the receive agent is more complicated due to the heterogeneity of receive networks. Fees vary according to the specifics of the network utilised.

As in the UK, some MTOs work through an already established network in the foreign country; for example using existing bank infrastructure, or through institutions such as the Post Office. Other larger MTOs use an agent model, similar to that in the UK, to process and disseminate cash. In some cases, the UK MTO is part of a larger parent group that takes control of receive country pay-out.

A single corridor specialist that channels money through an existing network can pay the receive agent (bank network in receive country) as little as 15% of the total fee plus all the FX earning in order to process and deliver the transaction. Other operators give 50% of the total fee plus FX earning to a parent company to take control and organise the delivery of the funds.

There is inconsistency between operators as to whether the receive agent fee varies according to the country. Some MTOs report that the fee that they pay their agents varies according to the costs, competition and the cost of compliance in the foreign country. This suggests that in countries where the cost of non-tradables is high (high rent, labour costs etc) and/or competition between agents is high and/or the cost of compliance is high and time consuming then agents can demand more for their time to process the transaction.

Conversely however, some MTOs report to have standardised agent fees across all countries; reporting that agents in foreign countries have an understanding of how much the UK MTO is making from the transaction and therefore have an understanding of how much they can demand from the MTO for their services. In this, the most typical case, receive agents also earn between 20% and 30% of the fee plus FX earning.

iii. Bank Costs

It is approximated that 70% of MTOs operating in the UK market bank with Barclays. A few years ago there was a problem with smaller MTOs not being able to find a bank to bank with which presented a

major barrier to entry. The problem is still significant because not only is one bank dominant but two of the other banks have taken policy decisions not to offer accounts to MTOs and another has set very high barriers to be overcome in order to open an account. Most of the banks maintain that the MTO sector presents a greater risk because of anti-money laundering threat, than other sectors. The consequence of this is that there is presently very little competition in the market and banking costs for MTOs reflect this. There needs to be clarification from the regulatory authorities as to whether the banks have second-level responsibility when dealing with MTOs.

There are two main different types of bank costs charged to MTOs. There is a fixed monthly charge for holding an account and variable fees for every time a transaction is made, i.e. money is credited or cash is paid into an account.

Costs structures vary according to the bank, but also vary according to the MTO. The bank assesses both the risk and the potential value from an MTO and sets the fees and charges accordingly.

Wholesaler

There are a few wholesalers that operate in the UK market that undercut the costs charged by banks (whether this is in terms of the transaction or the bank depositing fees). The wholesaler works on a bulk processing basis and takes the risk responsibility for errors and forged notes. The costs charged to MTOs are less than with a bank.

In order to minimise the risk and compliance issues involved with being a wholesaler, they typically will not deal with MTOs that use the agent model. This is because there is higher risk in dealing with agents as there is no incentive for an agent to ensure the cash they are handling is clean.

Wholesalers are filling a gap in an uncompetitive market.

1.	***Cost of having a bank account – facility fees***	**Fixed**

Not all MTOs will reveal the costs that they incur from their bank. However, results from MTOs and discussions with banks indicate that to hold an account can cost as little as £5 per month with the guarantee that the MTO will process a turnover through the bank of more than £4 million per month; £10 monthly fee for a well established money operator; and, as much as £3,000 a month with no conditionality for new 'high risk' businesses.

2.	***Bank Charges – cash-handling fees and transaction charges***	**Variable**

Bank charges are those that MTOs have to pay the banks to process their transfers and settle their payment. These are variable costs that increase with the volume of transactions. Hitherto, bank costs have been excluded from the literature on the cost structures of MTOs. This is surprising as according to MTOs surveyed, bank charges are among the most burdensome costs experienced by the MTOs operating in the UK market.

The more valuable the MTO is considered to the bank, the better the fee package they will be able to negotiate, but only within a certain margin. According to the banks, charges are likely to be higher for the first three to six months of operation whilst the bank creates a profile for the MTO. Once this

has been established costs are likely to fall. This has been verified by MTOs operating in the UK market that have seen their bank charges fall over recent years.

Banks charge at different levels depending on the relationship and negotiations they have with the operators. According to the banks their charges competitively reflect the costs, time and risks they incur through each transaction.

As such banks have different charges depending on the type of deposit made into their bank account. For many of the MTOs operating in the UK, their business is predominantly cash based. Therefore cash is paid into their bank account by the MTO or their agent. (Note that the agent does not pay money into their own account and then forward it electronically to a bank because the agent would then need to pay the bank charges)

There are a number of risk and logistical problems involved in dealing with cash which are thus reflected in the charges passed onto MTOs. Bank costs vary depending on how the cash is deposited with to the bank. If the MTO arranges for the cash to be deposited at the bank, then the charges will be less than if the bank has to collect it from the MTO. This is because there is a risk of theft involved in the movement of cash.

Furthermore, banks will also charge according to the way that the cash is presented. Banks offer incentive based pricing on the presentation standard. If the MTO brings small denominations of notes then it takes longer for the bank to process and physically move the money, Coins are the most troublesome (and therefore expensive) to deal with. Banks argue that they have to staff their branches in order to deal with and process the deposits made by MTOs which is a timely and expensive process.

According to banks, they have fixed overhead costs to cover to process cash and this covered in the fees that are charged. In general, over-the-counter deposits are priced between £0.30 and £0.50 per £100 (but can go up to £0.80 per £100) paid in. For cash sent to a processing centre the costs are approximately £0.10 to £0.30 per £100 paid in but there are other costs for collection, etc. Volumes have to be at a significant level before an MTO can use a cash processing centre.

Other forms of payment or collection also incur a fee. For a debit transfer paid into an MTO's account there is a flat fee per transaction and for a credit transfer the fee is a percentage of the transaction.

The main determinants of bank charges are:

1. Dealing and processing the transaction (especially if cash)
2. Monitoring; due-diligence & checks – SARS report
3. Audit – intermittent visits to the MTO

Banks claim to only make a small margin on top of their costs, and in some cases MTO payments need to be subsidised by the larger corporate payments.

The majority of the MTOs report bank charges as one of their most burdensome costs. For example, a small brand MTO in the UK, with an annual turnover of less than £2mn, spends approximately £12,000 per quarter purely on bank deposit fees. Table 3 provides indicative UK banking fees experienced by an MTO operating in the UK market.

TABLE 3: INDICATIVE UK BANKING FEES

Indicative Bank Charges
DIB debit transfer @ £0.15 each
Credit transfer @ £0.25 each
Automated credit @ £0.14 each
Cash paid in @ £0.50 per £100
Cheque paid in @ £0.23 each
3 statements £0.95
Cash in cash @ £0.40 per £100
Cash in cash ctre checked @ £0.25 per £100
Same day entry @ £0.75

Source: A small single corridor specialist MTO

3.	***SWIFT***	**Variable**

MTOs and banks need to make settlement payments to their payout partners in the receiving markets. The most common method of doing so is to make a SWIFT payment.

SWIFT is a member-owned cooperative that provides the communications platform, products and services to connect over 8,500 banking organisations, securities institutions and corporate customers in more than 200 countries covering approximately 70 currencies.

SWIFT enables its users to exchange automated, standardised financial information securely and reliably, thereby lowering costs, reducing operational risk and eliminating operational inefficiencies. The cost of making a SWIFT transfer depends on the receive country:

EUR 0.06 per transaction (SWIFT)
EUR 0.05 per transaction (SWIFT – Euro-zone)

However, the fee paid by an MTO for an international settlement payment varies depending on the level negotiated but is often somewhere between £5 and £40 per transaction.

4.	***VISA / MasterCard***	**Variable**

Other electronic payment systems used in the money transfer process are MasterCard and VISA card payments. These are typically used in conjunction with online money transfer services and/or pre-paid cards. Some of the MTOs operating in the UK have deals with VISA / MasterCard that enables recipients to draw cash from ATMs. Charges associated with these payment methods are normally absorbed by the card user but there are scheme set-up fees and minimum income guarantees that must be paid to the card companies.
Many operators accept payment by card for transactions for their customers. There are fees associated with these payments that vary according to level of perceived risk of fraud associated with the card type. For example, a debit card that is 3D Secure and/or is signed up to Visa or MasterCard on-line check is slightly cheaper due to the reduced risk of fraud when compared to transactions taken by a call centre where the 'card not present' risk is considerably higher.

According to banks, the cash handling fee is currently less than if the same transaction is processed via a credit card. A debit card is cheaper than a credit card if dealing with payments of more than approximately £100. As it is anticipated that card payments will increase in usage over the next few years this is clearly an area that will need to be examined further to see if savings can be made. It is anticipated that card based payments should be significantly cheaper than cash handling fees in the future.

Bank costs are often cited as the most burdensome cost in the money transfer process, especially for the smaller MTOs. The bank market with regards to the supply of services to the remittance market is highly uncompetitive in the UK. This is an area that would be worthy of further investigation by government bodies.

iv. Regulation	Fixed

There are a number of areas in which Regulation has an impact on the costs of operating a remittances business. These include being an authorised or registered business, safeguarding of customer funds and compliance with anti-money laundering legislation.

Authorisation/Registration

In November 2009 the regulatory environment changed across Europe when a new regulatory regime came into existence as a result of a piece of legislation called the Payments Services Directive (PSD). The PSD introduced new classification of business – the Payments Institution (PI). PIs have, in effect, replaced Money Service Businesses (MSBs) and are regulated by the FSA. There are two types of PIs: Authorised and Small. All MSBs must apply to the FSA for Authorisation or registration as a PI and pay the relevant fees.

The Payment Services Directive (PSD) is an EU directive aimed at standardising retail payment services across the European Economic Area. Encompassing 31 countries in total, it aims to remove barriers to entry and encourage fair competition in payment services, establishing an equal set of rules across the regions. The initiation of such a scheme, however, comes with its overheads and this paper identifies the cost of implementation to many individual operators.

Whilst the PSD came into force on 1 November 2009 there are provisions for a transitional period during which time companies need to register and fulfil registration requirements. Businesses in operation before 25 December 2007 and requiring authorisation as Authorised Payment Institutions (PIs) can delay authorisation until 1 May 2011 (applications in by 1 February 2011), companies looking to be registered as Small PIs must do so by 25 December 2010, and applications to be in by 25 September 2010.

Banks, building societies, EEA authorised PIs, authorised e-money issuers, small e-money issuers, Post Office Limited and certain public bodies are able to continue providing services and do not need to register under the PSD.

The forms for registering as a Small PI are longer than those that were required to register as a MSB under the previous regime but are not overly burdensome. However, the application process for an Authorised PI is long and in depth and would take a considerable time for someone within a company to complete, especially as in many cases the company will have few employees and the nature of the information will require a person of seniority to be actively involved. Indeed many MSBs have recruited external consultants to help them through the process at fees ranging from £8,500 to over £20,000. (Further information on what is required to be become a PI is included in Appendix IV).

There are numerous fees involved. All those registering will require to be registered with the FSA Money Laundering Regulations (MLR), for which there is a flat fee of £100 if the business is not already registered. The attached table shows this and other relevant fees.

TABLE 4: COST OF DSP REGISTRATION IN THE UK

Small PI	Costs	Authorised PI	Costs
One-off MLR fee:	£100	One-off MLR fee:	£100
One-off application fee:	£500	One-off application fee:	£1,500*
Annual fee:	£400	Annual fee:	£400
Additional variable annual fee:	n/a	Additional variable annual fee:	Income based
Fine for late submission of forms	£250	Fine for late submission of forms	£250

*The application fee for Authorised PIs varies, the value here refers to money transfer operators with less than 2,500 agents.

Once registered, companies are required to provide reports on a quarterly and an annual basis. Additionally, there will be an annual fee which is £400 for Small PIs but which will be a variable fee based on income for Authorised PIs.

Safeguarding

To help protect customers' funds while they are being held by the payment institution authorised PIs must implement one of two specified safeguarding measures. The two measures are, broadly:

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- Segregate the funds received for payment services from others, or

- Arrange for the funds received for payment services to be covered by an insurance policy or by a comparable guarantee from a UK or EEA authorised insurer, bank or building society..

In practice the first option is the only one available to PIs as there are no suitable insurance products available in the market. This means that firms must make sure that they have sufficient funds in a 'client account' at a bank (or similar approved investment) to cover the value of the transactions that have not been collected within 24 hours of being sent. Many businesses that operate with agents are not able to collect the value from their agent within this time frame and must therefore tie up some of their working capital in being able to meet this requirement.

Identification requirements

Another aspect of regulation is anti-money laundering (AML). Being able to identify the customer correctly is a critical part of an effective anti-money laundering policy. There is not a necessity to see identification documents for a one-off transaction that is below EUR 1000 in value and does not arouse suspicions but each transaction must be screened against names that are listed on government 'watch' lists. Such a robust procedure must be in place to identify any possible misuse of an MTO's business. All agents and businesses are required to report any suspicious transactions.

To comply with every regulation each MTO has to have a Money Laundering Reporting Officer (MLRO). This is the responsible person within the organisation for ensuring that anti-money laundering policy is implemented effectively. In smaller MTOs the role of MLRO will be but one part of the role of a senior manager or business owner. In larger businesses the MLRO will be a senior stand-alone role and they may well lead a team of anti-money laundering specialists.

Aside from the additional staff cost, each MTO/PI must be registered with HMRC for anti-money laundering purposes. There is a fee of £120 per location per year. For those businesses with large agent networks this can be a very significant cost.

It proved difficult to determine the exact cost of AML activities for the businesses that were surveyed although all felt that it was a significant burden for them to carry.

Agents

An MTO/PI is responsible for ensuring that its agents are trained in the correct anti-money laundering procedures and that they are compliant with all appropriate regulations. This means that they must have adequate staff to not only review every transaction from a central function but also that they must be able to visit each agent on a regular basis as defined in their AML audit policy.

In addition, the PI is responsible for paying the £120 HMRC fee for each agent that is part of their network.

v.	**Staff**	**Fixed**

The number of staff that the business will need depends on the business model and, to a certain extent, the size of the operation. Staff are required for administrative purposes, to manage the business, and to ensure that transfers comply with the UK's regulations. According to most of the MTOs their staffing cost is their main fixed cost and Compliance Departments the fastest expanding area within the companies.

By automating more of the procedures, tracking devices, compliance requirements and transfer methods the operators will be able to reduce their staffing requirements and subsequently their costs.

vi. Marketing	Fixed

The degree of marketing depends on the size of the company and the visibility they require. International companies such as Western Union spend 5% of their annual revenue on marketing, whereas smaller operators in the UK market spend significantly less preferring to exploit more specialised channels such as local radio stations and newspapers to market their services. Online services often rely on viral marketing through the Internet and this is an area that is being exploited by more traditional MTOs.

Banks spend considerably less marketing their remittance services, as they more often than not see these services as only one product of their entire portfolio.

Note that for the purposes of this report marketing is seen as a fixed cost. Where specific pricing initiatives or reward mechanisms are provided on a transaction basis the marketing amount could be seen to be variable. However, as most operators use a combination of pricing and media promotion, among other methods, as marketing tools the item is considered as a fixed cost.

vii. Administrative Costs	Fixed

This category will cover all the basic administration costs that are necessary to run a business including office materials, stationery, postage etc.

viii. Rent	Fixed

Rent will depend on the number of offices and/or branches that the MTO requires in order to conduct business. The need for office space will depend on the business model and the number of employees. MTOs that use a number of branches will have higher annual rent compared with a predominantly online agency that requires only one head office.

Furthermore, as with any property, location will play a large role in determining the cost. MTOs that require prime locations on city high streets are going to have higher rent bills than those that can operate from a less-desirable head office location. Banks typically have high grade premises in prime locations within a town or street.

The high cost of rent, especially in the UK, makes the agent model an attractive model for MTOs as they benefit from the rent costs being paid by the agent.

The UK has relatively higher rental costs when compared with many other countries in Europe and this undoubtedly contributes to higher operating costs for MTOs than those based in many other countries.

ix.	**IT / Telecommunication Costs / Technology Costs**	**Fixed**

Most MTOs use a certain level of IT and telecommunications to process the transaction. Both money and a message have to be sent to the recipient in the receive country. This process usually involves a number of other parties that also require access to the information and / or the transfer of funds; this is typically done electronically.

Depending on the business model evoked, the usage of IT, telecommunications and technology varies considerably.

x.	**Foreign Exchange Risk Costs**	**Variable**

Typically the foreign exchange spread is an income stream. However, given that it also covers for the risk that the foreign exchange rate at the time of settlement has moved unfavourably against the exchange rate at the time of purchase, there is the possibility that, if managed incorrectly, it becomes a cost. Naturally, an MTO can not manage continual FX losses if it is to remain in business.

xi.	**Professional Fees**	**Fixed**

These include legal, auditing and consultancy fees. This is typically less than 10% of cots. A consultant dealing with the regulatory side of operating a MTO in the UK will cost MTOs approximately £40 per hour (for a telephone consultation); £250 per day; and/or £25,000 + VAT for a year. In addition, the FSA requires that all MTOs are audited by a chartered accountant.

Larger MTOs may employ consultants to assist with strategic initiatives whilst smaller operators do not have the resources to invest in this area.

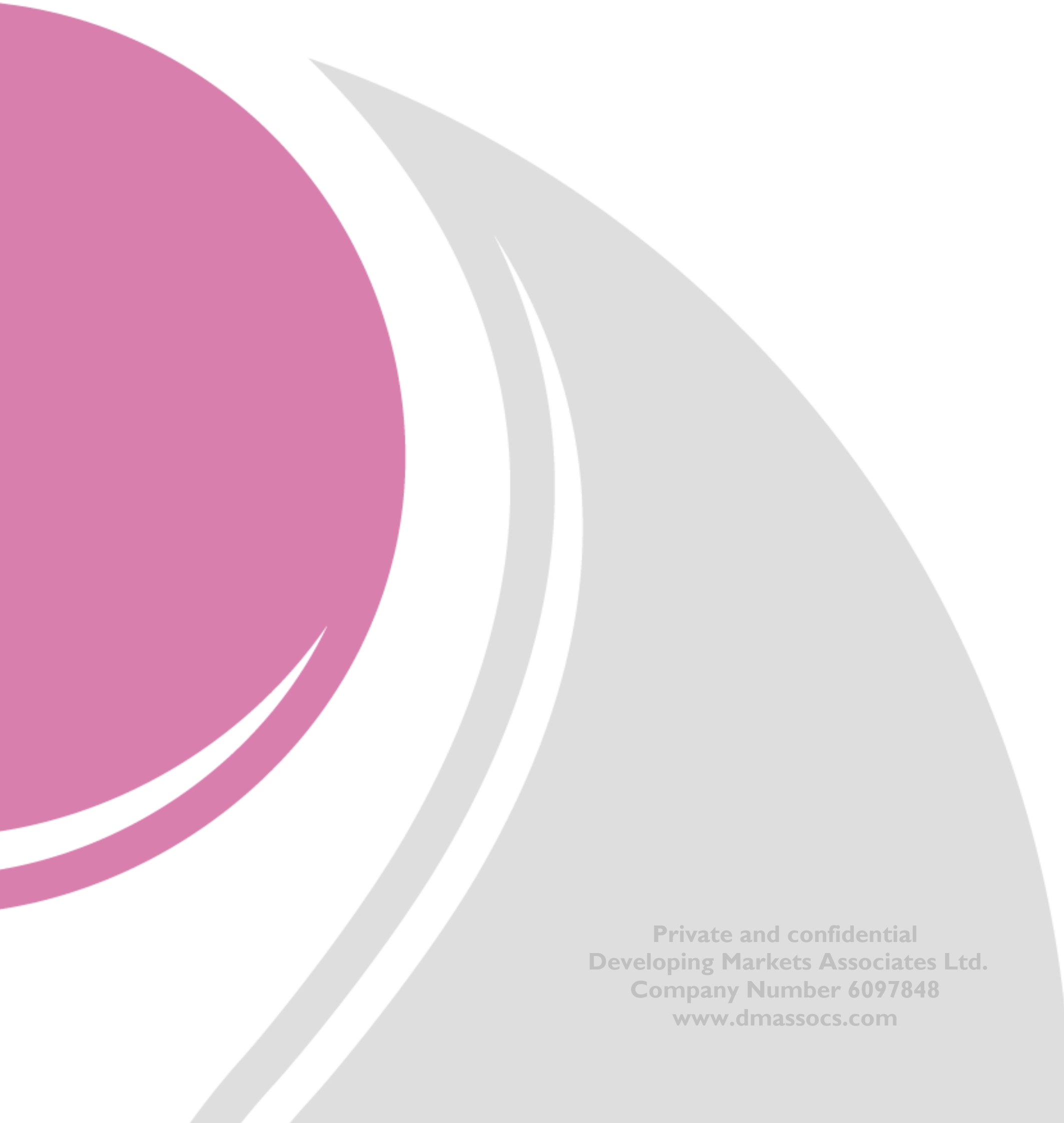
xii.	**Security Costs**	**Fixed**

Security costs vary according to the country and the risk involved with cash handling in these countries. In the UK the risk of dealing with cash will be considerably less than in other countries such as Nigeria. However, it is evident from the fees charged by the banks for the different types of cash deposit services that there are different costs involved with handling cash. Where the MTO chooses to take responsibility for handling and depositing the cash themselves, they must either run the risk of robbery or incur the expenses associated with using a security firm.

For electronic payments, the security risk is generally with respect to fraudulent activity, therefore the security cost can be synonymous with the compliance costs.

xiii.	**Opportunity Costs**	**Fixed**

As discussed many of the end-to-end value transfers in the money transfer chains do not actually happen in sequence and therefore there is need for liquidity. For example, many MTOs keep a foreign bank account with funds in it, so that they are ready to payout the money in the foreign country upon request. Providing liquidity has a cost – sometimes the cost of borrowing funds – and sometimes the opportunity cost of being able to invest funds that are already held. Safeguarding, under the PSD, will stand to increase this.



HOW COSTS VARY ACCORDING TO BUSINESS MODEL

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2. *How Costs Vary According to Business Model*

The UK has, according to HMRC, approximately 2,800[6] MTOs. The market is considered one of the most competitive globally with a number of different sized operators operating under a number of different business models, covering all corridors of the globe, providing different speeds of delivery and tailor-made services.

In the following section, the most common business models operating in the UK market are outlined and the different sources of revenue and costs identified. These include:

1. The traditional MTO business model (cash-to-cash)
2. More technologically advanced and new money transfer methods
3. Banks

The basis for the contents of this section is the financial statements of different MTOs and information collected from interviews with MTOs and banks. All information has been provided confidentially and therefore cannot be attributed to the operator.

Given the heterogeneity of business models operating in the market, estimates have been made in order to build illustrative models for each end-to-end value chain. The models aim only to provide a quantitative insight and a relative understanding to the different revenue streams and costs.

Figure 1 provides an overview of the money transfer process in general. The diagram clearly shows that there are a number of different methods and a number of different players that are or can be involved in the end-to-end chain. However, the overall structure is the same for all business models; where money is sent by the sender to the sending agent who transfers the money to the paying agent who delivers the money to the beneficiary. It is clear from Figure 1 that within any given money transfer system there are two separate but connected flows: one is the flow of money and the other is the flow of information.

[6] Source: HMRC estimates

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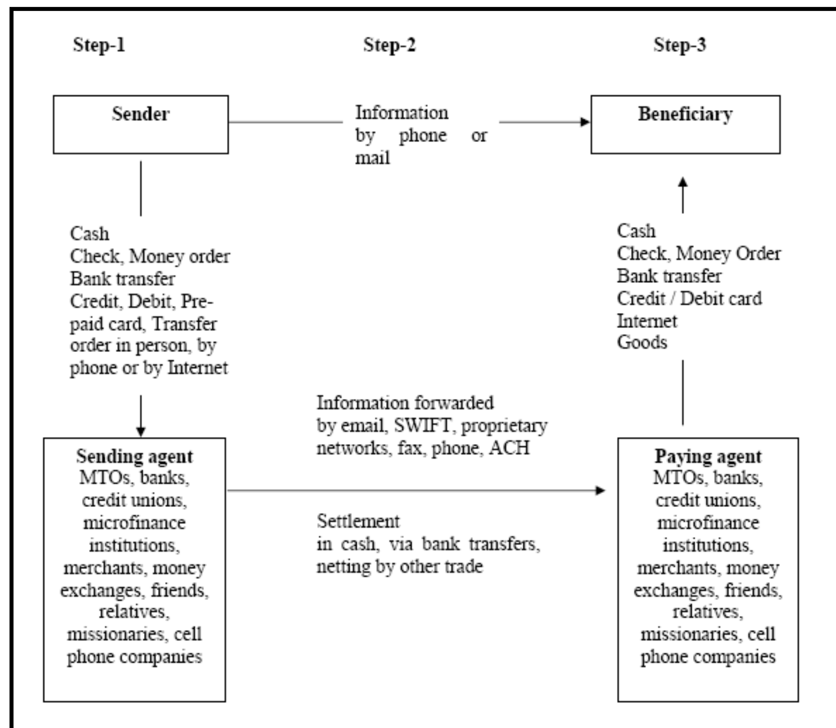
Figure 1: Money Transfer Flow



Source: Ratha & Riedberg (2005a) p11

i. The traditional MTO business model (cash-to-cash)

Traditional MTOs operating in the UK usually operate offering either one or a combination of the three different services highlighted below:

a) Agent-to-Agent (cash-to-cash)
b) Branch-to-Branch
c) Remote Ordering-to-Agent

In the following section each of these end-to-end value chains shall be looked at independently.

I. Agent-to-Agent (Cash-to-Cash)

At present, this is the most popular and traditional remittance method used internationally. The cash-to-cash service allows the sender to visit a MTO agent, deposit cash with the agent and for the receiver to collect cash from an agent in the receive country.

The largest operators globally using this model are the likes of Western Union and MoneyGram that have established agent networks in 200 and 190 countries respectively. Smaller UK based corridor specialists also use this model, such as Unity Link for UK-Ghana and Iremit for UK-Philippines.

FIGURE 2: AGENT-TO-AGENT FLOW

1. Sender Pays Cash to Agent

The UK based agent is responsible for taking the cash and the information required in order to identify the recipient. Over a certain threshold the agent will also take the sender's identification. The agent will charge the sender a fee and an FX spread. In some corridors the MTO will not be able to make a profit margin from the FX spread, either as the Central Bank in the recipient country prohibits it, or due to competition in the corridor that has driven down marginal revenues over time.

Revenue: Fee + FX spread

Cost: Agent Fee (variable)

The information relating to the transaction travels separately from the money; this means that often the beneficiary can pick up the money as soon as the transfer has been paid for in the UK. This has implications on both liquidity (ensuring that the receive network has the funds to make the payment before the transaction has been settled) and exchange rate management (insuring against the probability that the exchange rate will have changed by the time the MTO comes to settle the international payment).

2. Agent Deposits Cash in Bank

At some stage the cash collected from the agent is deposited into the bank. The agent can either take the cash and deposit it into the MTO's bank directly, or the MTO can arrange to collect the cash from the agent and deposit the cash into the bank, or the MTO can arrange for the bank to collect the cash from the agent or MTO. The method used and the frequency with which this takes place will depend on the MTO's preference, the volume the agent is transacting and the perceived level of risk. The agent will pay a fee to deposit the cash with the bank that they will then pass on to the MTO.

Cost: Bank Fee (variable)

3. FX Exchange

With the cash deposited into the bank account, at some stage the international transfer will take place. The MTO can decide on the frequency with which they make the international transfer, but the MTO will usually batch transfers together into one single payment over a period of time. For some UK based MTOs their foreign bank partner will have a UK account. Money will then be transferred by a simple domestic payment into the foreign bank's UK account. This will similarly allow for the batching and netting of funds overtime.

Cost: International Transfer (Variable)

4. Foreign Bank / Agent Network

The MTO will have a partner in the receive country to receive the funds. The partner can either be through an established network in the receive country (for example through local banks, the post office) or through a network set up by the MTO. Once the money has arrived in the receive country's bank, a number of different models can be used to distribute the money to the beneficiary. This will depend on the service offered by the MTO to the sender. The receive-bank can either be used to supply the cash to the recipient through their own network, or the MTO will have other network arrangements, such as through other banks, the Post Office and/or their own branches and/or a network of franchised agents. This will usually involve a domestic transfer from the receive bank to the distributor.

Cost: Agent - Abroad Fee (variable)

In addition to variable costs, MTOs operating this model also require a supporting office to manage the transfer process.

Table 5 gives a real life example of sending £300 from the UK to Jamaica with a UK based MTO operating the agent-to-agent model. The example gives an idea of the fees and FX earning from one single transaction of £300 and how much of that earning immediately goes on cost of sales. From an initial fee and foreign exchange earning of £18.51, only £8.06 is left for the MTO to cover their fixed costs.

Example: Sending £300 to Jamaica from the UK with a UK-based Operator	
Inter-bank Exchange Rate (JMD)	139.73
Send	£300
Fee	£11
Operator Exchange Rate (JMD)	136.23
FX earning	2.50%
Revenue FX	£7.51
Total Fee + FX Earning	£18.51
Agent Home Fee (30%)	£5.55
Agent Abroad Fee (20%)	£3.70
£0.40 per £100 deposited in cash	£1.20
Remaining Revenue	£8.06

Table 5: Example of £300 sent from UK to Jamaica

Illustrative Example

Table 6 provides the assumptions of a model - compiled from a number of different financial breakdowns of MTOs operating under the agent-to-agent business model. The figures highlighted in orange show the assumptions made in the model. It is assumed that the home agent takes 30% of the fee and foreign exchange earnings. The foreign-agent takes 20% of the fee and foreign exchange earnings. Bank charges are approximately 10% of the revenue earned. In the standard agent-to-agent model, it is assumed that profits are 5% of the revenue earned. This figure is based on the profits of MTOs currently operating in the UK under this transfer model. The breakdown of fixed costs is also based on the experiences of MTOs operating in the UK.

Agent-to-Agent Model		
Home-Agent Fee		30%
Abroad-Agent Fee		20%
Bank Charges		10%
Cost of Sales		**60%**
Rent	15%	5%
Staff	45%	16%
Admin	15%	5%
IT / Telecomms	8%	3%
Marketing	8%	3%
Professional Fees	10%	4%
Fixed Costs	**100%**	**35%**
Profit		**5%**

TABLE 6: ASSUMPTIONS FOR THE AGENT-TO-AGENT MODEL

An additional cost in the agent-to-agent model, is the fee that that the MTO has to pay to register their agents. The weight of this cost will depend on the number of agents the MTO chooses to employ. This cost has not been included in the illustrative example.

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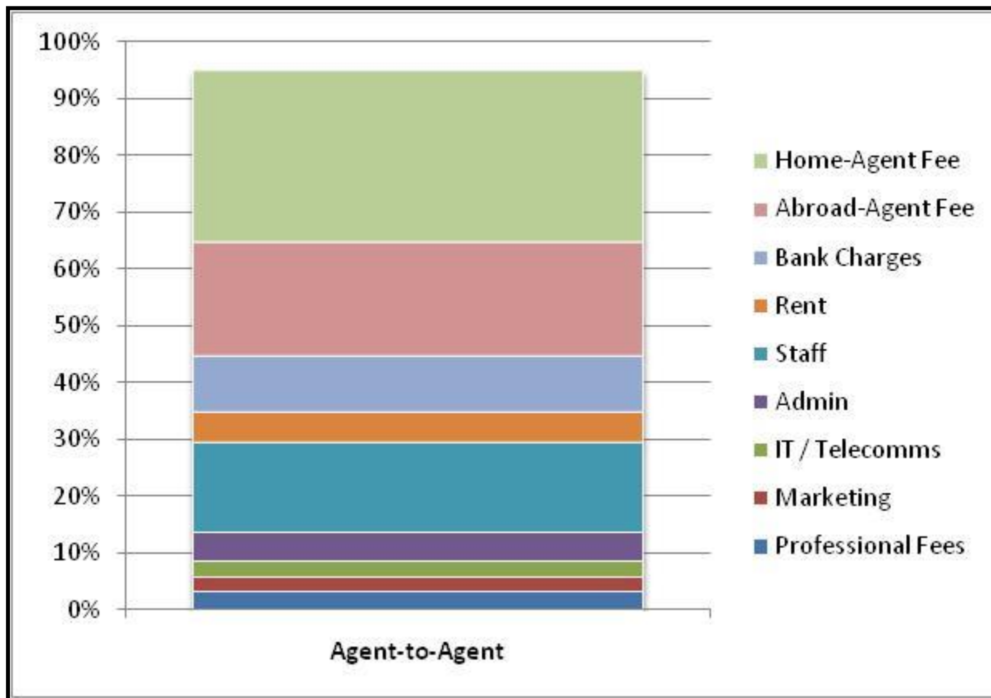

FIGURE 3: BREAKDOWN OF REVENUES FOR THE AGENT-TO-AGENT MODEL

Figure 3 shows the fixed costs, variable costs and profits as a proportion of the revenue for a typical MTO operating this business model. The graph shows that the variable costs account for 60% of total revenue and staff accounts for the largest proportion of fixed costs.

2. *Branch Model (Cash-to-Cash)*

The branch model is similar to the agent model described above. However, the sender, rather than visit an agent, visits a branch which is operated by an MTO and deposits the cash with them. This removes the need for an agent in the send market (see Figure 4).

Most MTOs do not charge the sender a different fee depending on whether they visit a branch directly or whether they use an agent although - this is the practice in some markets such as Spain. In the branch model the MTO is able to cut out the cost of the send-agent and therefore the variable cost of sale is reduced.

However, to operate the branch model, not only is a head office needed, but the MTO will also need more than one branch to guarantee the required volume of transfers. Therefore, the fixed costs necessary to operate a branch model are likely to be more than in the agent-to-agent model. In the illustrative example below both the rent and the staff costs have been doubled in relation to the agent-to-agent model.

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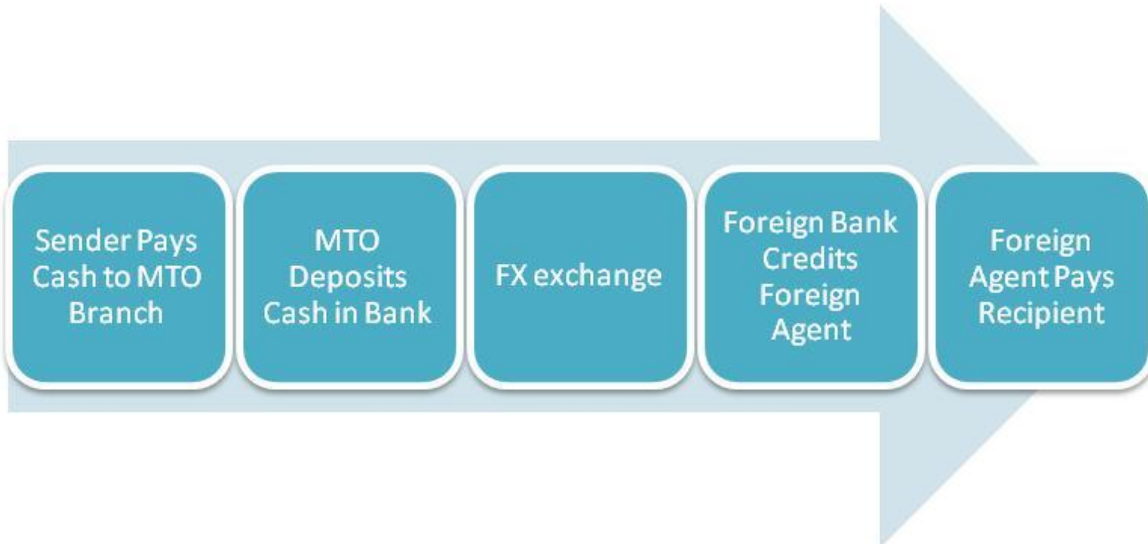

FIGURE 4: BRANCH-TO-AGENT FLOW

Illustrative Example

The model for the Branch-to-Agent model has been created in relation to the Agent-to-Agent model with a few amendments to the original assumptions. The assumptions are highlighted in orange in Table 7.

Assumptions:

1. ***Assume an annual revenue of £1mn***
2. ***Double the costs of rent and staff***
3. ***Other costs remain the same***
4. ***Foreign Agent Fee remains the same***
5. ***Bank charges remain the same***

Branch-to-Agent Model		
Revenue (£)		**1,000,000**
Home-Agent Fee		0%
Abroad-Agent Fee		20%
Bank Charges		10%
Cost of Sales		**30%**
Rent	19%	11%
Staff	56%	32%
Admin	9%	5%
IT / Telecomms	5%	3%
Marketing	5%	3%
Professional Fees	6%	4%
Fixed Costs	**100%**	**56%**
Profit		**14%**

TABLE 7: ASSUMPTIONS FOR BRANCH-TO-AGENT

Figure 5 shows the allocation of revenue for the branch model. The graph shows the composition of costs and the profit as a percentage of revenue earned. The profit in the branch model is 14% of revenue which is higher than for the agent model. By removing the send-agent from the process, the MTO has been able to increase profit.

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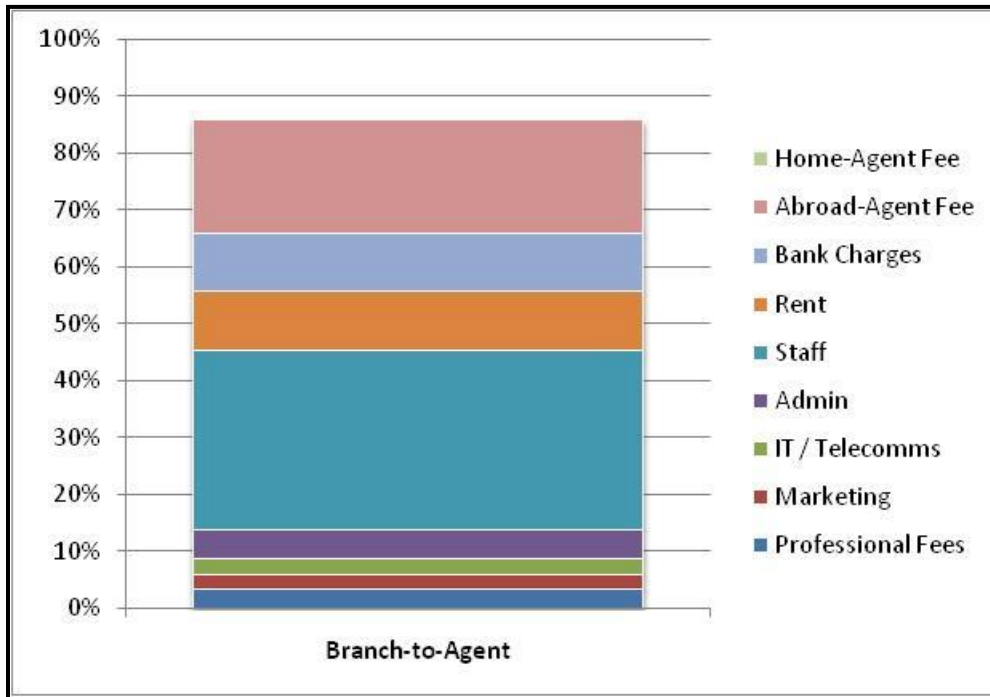
FIGURE 5: BREAKDOWN OF REVENUES FOR BRANCH-TO-AGENT



For many operators the costs of running their own branches significantly outweigh the saving in not having an agent. The branch model will only be profitable in high volume locations.

3. *Remote Ordering-to-Agent*

Many of the MTO UK operators also offer a service that allows the sender to deposit money into the MTO's bank account directly via bank transfer or cash deposit. Figure 6 gives the flow of operating a remote ordering-to-agent business model.

FIGURE 6: REMOTE ORDERING - TO -AGENT FLOW

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1. Sender Makes Banks Transfer to MTOs Account

The sender registers with the MTO in advance in order to provide the ID to the MTO to comply with KYC. Transaction details are provided by telephone or online. The sender is provided with a security pin that will allow the MTO to comply with AML and track transactions.

The sender transfers money from their bank account to the bank account of the MTO either online or via telephone.

Cost: Head Office Process Transaction (Fixed)
Cost: Bank Transfer Cost (variable)

2. FX Exchange

With the cash deposited in the bank account, at some stage the international transfer will take place.

Cost: International Money Transfer (Variable)

3. Foreign Agent / Network

The MTO will have a partner in the receive country to receive the funds. The funds are delivered to the receive agent.

Cost: Agent-Abroad Fee (Variable)

Assumptions for Illustrative Model

An overview of the assumptions is provided in Table 8. By getting customers to use the remote order method, the MTO is able to remove the send-agent from the process. It is assumed that a receive-agent is still required. Similarly, a head office is also required to support the business. In some cases this will require higher central costs to process the transactions and in others this is absorbed in current activities. It is assumed here that the fixed cost component is the same as for the standard agent-to-agent model. Bank payments will be made through direct credit or through cash deposit. It is assumed that bank charges stay at 10% of revenue.

Remote Ordering Direct Debit		
Revenue (£)		**1,000,000**
Home-Agent Fee		0%
Abroad-Agent Fee		20%
Bank Charges		10%
Cost of Sales		**30%**
Rent	15%	5%
Staff	45%	16%
Admin	15%	5%
IT / Telecomms	8%	3%
Marketing	8%	3%
Professional Fees	10%	4%
Fixed Costs	**100%**	**35%**
Profit		**35%**

TABLE 8: ASSUMPTIONS FOR REMOTE ORDERING MODEL

From Figure 7 it is evident that by processing the transaction electronically either via telephone or online reduces the cost of sales and increases the margin for profit. In this illustration the MTO using remote ordering is able to increase profits significantly from 5% in the agent-to-agent model to 35%. However, it is assumed that the annual revenue is constant at £1 mn.

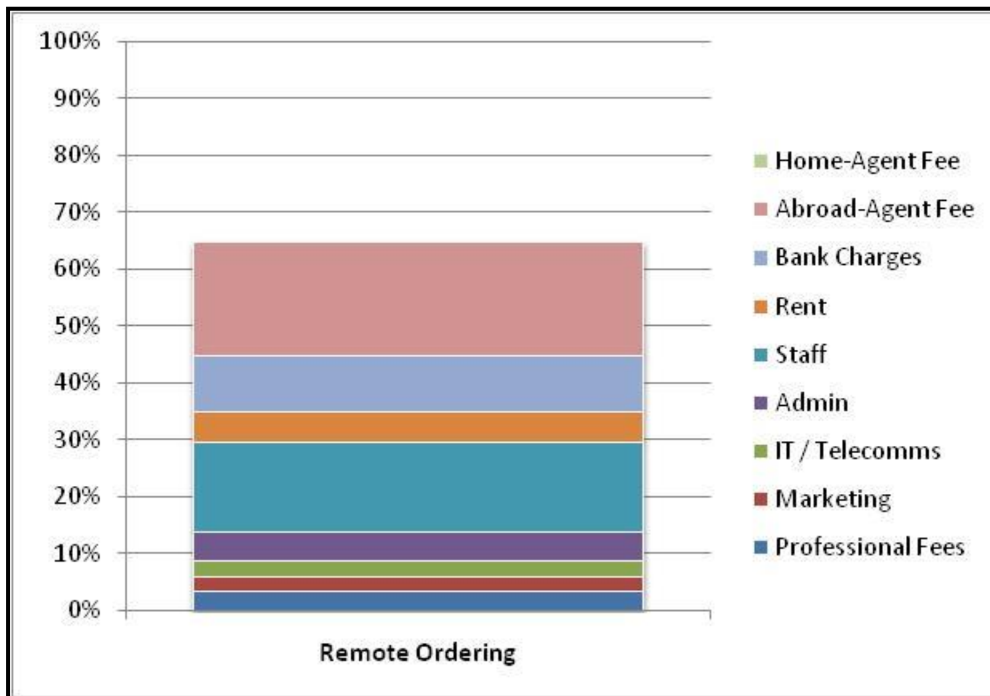

FIGURE 7: BREAKDOWN OF REVENUES FOR REMOTE ORDERING MODEL

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ii. New Money Transfer Models

Innovative solutions and new business models are being designed to provide customers with cost effective and competitive alternatives to the more traditional methods of money transfer. These include online and in due course may include mobile payments (although there are very few examples of successful cross-border payments initiatives).

1. Online

At the moment the number of operators offering online money transfer services is relatively small in the UK. However, this may change as MTOs increasingly see the value in moving online, banks launch their online services and the E-money regulatory regime changes. The biggest driver will, most likely, be the behaviour and demand patterns of the Diasporas in the UK.

In the current market the UK Diaspora are relatively conservative in their behaviour patterns – although some communities are prone to new product uptake than others – with a strong preference for the more conservative and traditional transfer methods; cash-to-cash. However, interviews with some operators have shown that many of the UK Diaspora are well-banked with a relatively high prevalence of both mobile phones and access to the internet and are therefore equipped to be able to take advantage of these new services. As it becomes more commonplace to purchase items over the internet and as the UK's Diaspora matures, so they will become more trusting of online operators and utilise their services.

Whilst the Diasporas in the UK are well positioned to take advantage of these new technologies, beneficiaries tend not to be as well equipped. Therefore one of the challenges with the online service providers is how to get the money into the receiver's hands in cash. This is known as the problem with the 'final mile'.

There is no standardised business model for online operators. However, Figure 8 provides an overview of a simple online money transfer process. Online MTOs currently offer a set price independent of where the money is being remitted to but there is no need for this to be the standard model.

The fees that the online operator charges in comparison to the more traditional methods are extremely low. In this example there is a flat fee of £0.50 per transaction and it is assumed that there is a 2% FX spread. An online MTO is most likely to make the majority of their revenue through the FX fee.

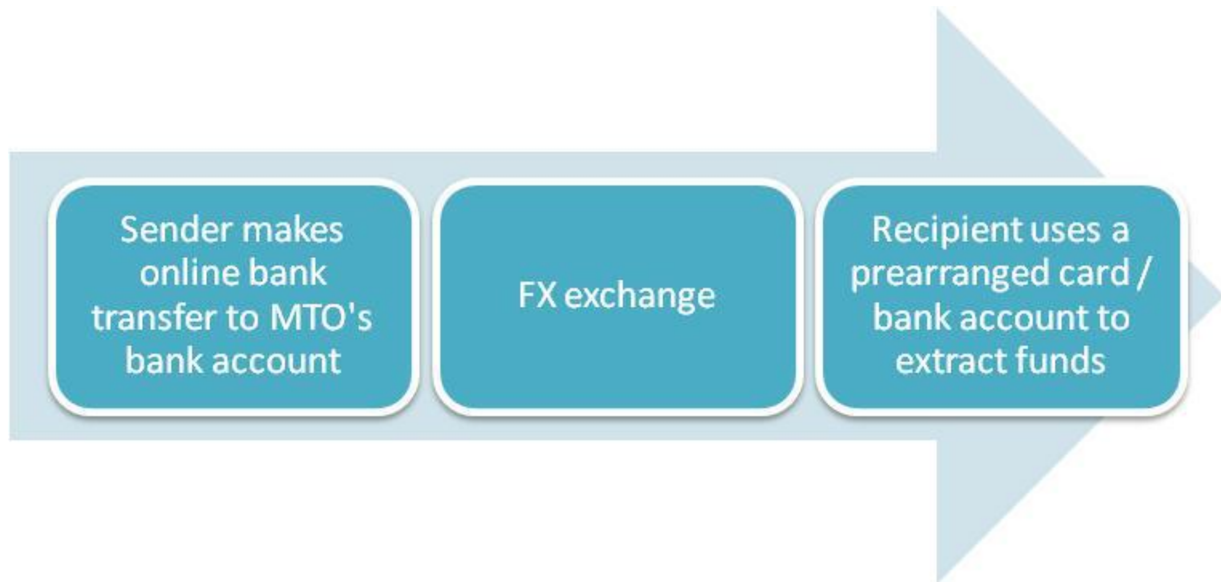

FIGURE 8: ONLINE OPERATOR FLOW

1. Sender Makes Online Transfer to MTOs Bank Account

A new customer registers with the online MTO and opens an online account or pre-paid card. Details are then checked against bank details. By ensuring the sender has a registered and approved bank account, the online money transfer operator avoids issues of KYC and AML required by HMRC and FSA. In some cases the recipient must also be registered with the same MTO. Some online MTOs have also been creative in developing new security checks and internal risk assessments to further reduce the incident of fraudulent activity. For example:

- A transfer limit per day
- A total transfer limit
- Only one PC fingerprint to one registered user
- Only European bank accounts
- Match bank account origin to computers location
- Send a temporary pin number to the sender's mobile phone and/or email address.
- Send customer a pin to their address

The sender goes online and makes an international money transfer to the recipient.

Revenue: Monthly Fee
Revenue: Fee + FX spread (variable)
Costs: Registration

2. FX Exchange

With the cash deposited in the bank account, at some stage the international transfer will take place.

Cost: International Money Transfer (Variable)

3. Receive / Agent Network

How the money is collected on the receive-end depends on the MTO.

- Utilise an existing agent network to supply cash (such as agents, banks, Post Office etc) – this will involve paying a receive agent fee
- Deposit funds into a foreign bank account (a local bank transfer)
- A card sent to the recipient that uses MasterCard / VISA etc to allow recipients to access funds through ATMs (the MTO will charge the recipient a fee – similar to that of a direct debit transfer – to extract the funds.

Costs: Receive-Agent Fee (Variable)
Revenue: ATM fee (Variable)

Given the risks involved in processing transactions online, the online operators tend to have much larger compliance teams than in the more traditional MTOs. Online MTOs are found to work closely with the FSA to ensure compliance levels and have in general found the FSA to be helpful and flexible at adapting regulations to fit new business models. In order to circumvent security issues, some of the main online operators only offer services to customers in relatively developed and secure markets.

Online operators also require a back-office for support and other fixed costs; however these are also kept to an absolute minimum as they endeavour to automate as much of the process as possible. Staff requirements are kept to an absolute minimum; however, given the security risks involved the online operators tend to spend more than traditional MTOs on compliance officers. Unsurprisingly, the online model requires larger capital investment into IT software and development. Quite often, online MTOs will rely on marketing to be done virally through the web.

Bank charges in this model are applied for acceptance of payment by card. The operators who were surveyed were paying fees ranging from £0.30 to £0.98 per transaction regardless of value. This is a significant range and can affect the profitability of a particular model.

Another option will be for the online MTO to accept payment from a consumer via Faster Payments. Faster Payments has been introduced by the banks in order to achieve same day cleared transfers between bank accounts. Banks do not currently charge for this. If this method was used to pay an MTO there would be no bank fees involved.

Presently, a number of traditional MTOs are beginning to offer online options alongside their other services. These initiatives enable receivers to collect money in cash. So far the online only MTOs have only enabled customers to credit an account or to use an ATM card which clearly limits the number of countries to which money can be sent effectively.

The fact that online operators are able to offer low prices indicates that their cost structures are minimal and they are confident they can attract sufficient volume to cover their fixed costs. If they are able to gain market share then they will undoubtedly influence prices to fall further.

2. ***Mobile Phone***

According to GSMA, mobile phones outnumber ATM's by two thousand to one, giving Mobile Network Operators a level of reach far outstripping that of money transfer providers and banks. With this, Mobile Network Operators (MNOs) can solve the access problem and drive down costs to levels

that that will open the formal remittance channel to those currently risking informal remittance channels.

Mobile technology can lower the cost of remittances as it removes the need for physical points of presence and ensures a timely and secure method of transaction. This concept of 'e-cash' is extremely attractive to low income users in particular.

The ubiquity and high penetration rates of mobile technology around the world provides Mobile Network Operators with the potential to vastly improve and transform access to remittance funds for people in developing markets. The GSMA forecasts that the 'formal' global remittance market could be grown from around US$300 billion today to over US$1 trillion in five years with the help of mobile communications.

However, there are a number of challenges with mobile payments that are yet to be addressed. A pure mobile payments model will need to work with a local e-payment infrastructure. Otherwise the message to the receiver that they have received money will mean that they have to go to a physical location or ATM and withdraw funds and the service provider of the cash will need to be compensated.

So far Kenya has been hailed as a leader in mobile payments as a result of the MPesa initiative (which started as a result of seed funding from DfID). The success of the domestic transfer market for MPesa has led to the introduction of a trial in the UK involving a number of operators transferring money to MPesa. The fees currently charged for this do not differ from fees for other forms of money transfer and the benefit for the consumer is therefore in the increased convenience.

There is currently insufficient experience of live operating models to assess the cost impact of mobile payments. Potentially they could lead to significant cost savings if a different level of remuneration is agreed for the agent model or if receivers do not need cash and can make payments electronically using the mobile wallet that would be part of the phone. Once further pilots have been launched it will be possible to build similar revenue and cost models to the others in this paper but at the current time there is a lack of available evidence.

iii. Bank-to-Bank

In order to use a bank-to-bank service, senders must hold an account with a UK bank and the recipient must also have a bank account (see Figure 9). For the majority, the sender has to visit a branch of the bank and instruct the bank to make an international payment unless the customer has enabled telephone banking in which case they would be able to complete the transfer over the phone. As yet, most UK banks do not offer this service online, but according to some this will change in the forthcoming year.

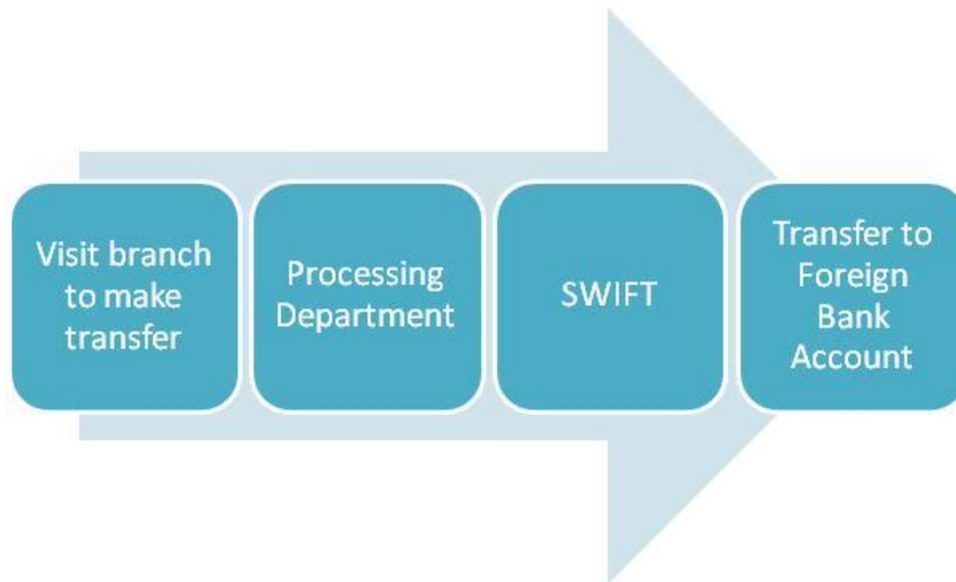

FIGURE 9: BANK-TO-BANK FLOW

The use of the bank-to-bank service is often constrained in the remittance market due to the number of people that do not have bank accounts in developing countries, which is estimated to be 80% and can be as high as 95% in some markets.[7] Banks, typically, have not been particularly interested in being competitive in specific market corridors, but offer the service in order to be able to offer a full range of services.

In the case of the bank-to-bank transfer, and differing from MTO agent model previously examined, each international transfer is processed separately by the bank. The bank branch takes the details and ID of the sender, which is then faxed through to the pre-processing centre. Here the details of the sender are checked and then, upon approval, are faxed through to the processing centre. Money is not debited from the account until the international payment is made. The international payment takes place through SWIFT itself.

If the money needs to be sent to a bank that is not using SWIFT, then the UK based bank will find a correspondent bank in the receive country to send the money through. The bank-to-bank model is advantageous as it operates under an open network, where money can technically be sent to any bank account in the world.

Given that the money is actually processed with the information, in other words money is not paid out to the receiver until the funds are actually received by the receivers bank, there is a time lag involved in processing the transaction. The timescales vary from country-to-country. Sending money to the US or within the Euro-zone is generally very fast, whereas somewhere such as the Middle East will take longer (approximately 2 days). Once the money has left the UK bank account and gone through SWIFT, the UK sending-bank no longer has any control over the receipt of funds.

[7] Source - CGAP

Bank-to-bank transfers tend to be relatively more expensive than other transfer methods. In general banks have three revenue streams in processing an international money transfer:

1. Flat fee otherwise known as bank charges
2. FX spread
3. Float

It is not possible to model the bank model in the same way as the previous MTO business models as remittance transfers do not show-up independently of other international payments and therefore understanding the cost components involved is not attainable.

Money transfers made through the bank are all treated as single transactions and therefore there is no room for the batching of funds. It is therefore fair to assume that on average the fee charged for each transaction covers the cost of the transaction. In fact, banks claim that in reality the corporate international money transfers subsidise the smaller money transfers (including remittances).

According to banks, the bank charges paid by the sender cover the cost of the bank charges. Therefore, if the sender chooses an 'Ours' option then the bank charges will reflect this, and similarly for 'Share' and 'Ben'.

Example: Non-Resident Indian (NRI) Initiative

Some banks have used remittances as a hook to attract new customers and to cross-sell to other products and services. Barclays Bank has adopted a commercially viable initiative that directly links remittances and financial inclusion in the UK. It is a twofold financial inclusion approach focussing on remittances to bring NRI's access to UK banking facilities and access to overseas banking simultaneously. Barclays have created a one-stop-shop for home and host country banking. The initiative has been tailored to the specific needs of the NRI with Indian language speakers in key locations, a low opening balance, free international ATM and debit card, a cheque book for the account holder and mandated holder, and free money transfers.

The Indian community in the UK is large enough to have attracted the attention of many banks. These cannot be described as 'loss leaders' as the banks are still earning foreign exchange revenue but compared to the normal charges for remittances via banks they are considerably discounted. The concept is that these same customers will avail themselves of additional products from the bank, such as savings accounts, insurance products, etc. which will earn revenue.

Testament to the demand for these services is that by the end of 2009 844,000 of cash-card accounts had been opened in the UK, with approximately 23,000 being opening each month. In addition 22,000 accounts have been opened in India.

FIGURE 10: NRI ACCOUNT WITH BARCLAYS

Based on the assumption that each money transfer fee covers the cost of the transfer it is fair to assume that on average an international transfer through the bank costs over £25 (the average fee) plus the foreign exchange spread. According to the banks the main cost incurred in making the money transfer is the cost of staff and the time that is taken to process each transaction. In general banks staffing and rent costs are higher than the average MTO as they have:

- Better paid staff with better benefits
- Buildings are better quality and located in more expensive streets / neighbourhoods

What is clear from the bank model is that, given fees are fixed, the fee becomes proportionally less as the send amount increases. Banks argue that it is not currently economical for them to process small transfer amounts under their current model.

iv. SWIFTNet Remittances

In recent years, SWIFT has introduced a new service tailored to meet the needs of the remittance market. SWIFTNet Workers' Remittances, as it is named, is a service that aims to replace proprietary bilateral arrangements for the clearing and settlement of low-value, cross-border, person-to-person payments. It offers improved straight-through processing and enhanced scalability for these bilateral payments.

Banks active in the market generally develop specific proprietary or bilateral services. While these are effective, they lack scalability. Where open correspondent banking arrangements are used, these payments are undifferentiated from other cross-border services. In these cases customer service and processing efficiency are suboptimal due to a lack of clear market practices and standards. Workers' Remittances addresses these issues. Its objective is to make the bilateral model scalable and efficient. Banks have the opportunity to use this service which may reduce costs.

In effect this model will allow banks to deal with other SWIFT members (predominantly banks) to offer money transfers that have the same characteristics as the cash-to-cash model, i.e. cash disbursement, same day payout, transparent fees and FX.

This service has recently been introduced by SWIFT so it is too early to measure the size of the impact that it will make but it is known that there has been significant early interest.

The service is currently only eligible to banks - to help them process remittances more efficiently. There are currently 37 banks signed up and it is reported that it reduces the cost by approximately 80%. As financial institutions' regulations change over the next year, institutions eligible for this new initiative might also be subject to change.

v. Recommendation

Banks should be encouraged to change their business model to recognise the potential benefit of the remittance market. Early steps can be seen through the SWIFTNet Worker Remittances and the NRI

solutions offered by Barclays. Better business models more tailored toward the remittance market would help to reduce costs of remittance transfers and work toward improving financial inclusion both in the UK and abroad. UK banks should be educated to use SWIFTNet Remittances service and provided with a new business model that is safe and cost effective for them.

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3. How do these costs vary with volumes and with the size of transactions?

In the money transfer business there are two main ways that the company can reduce the marginal cost of each pound transacted. This can either be done through an increase in the volume of transactions (akin to the size of the business through annual revenue) or through the batching or netting of transfers.

i. **In any business with fixed and variable costs, the marginal cost will decrease as turnover increases.**

Using the agent-to-agent model for example, it is clear that as the value of the transfers increase, the number of transactions needed to break even falls (see the example in Figure 11). This is unsurprising and relates to the fact that there are annual fixed costs that need to be covered. When the total amount of money being transacted increases, so do the fees earned and thus it takes less transactions to break-even.

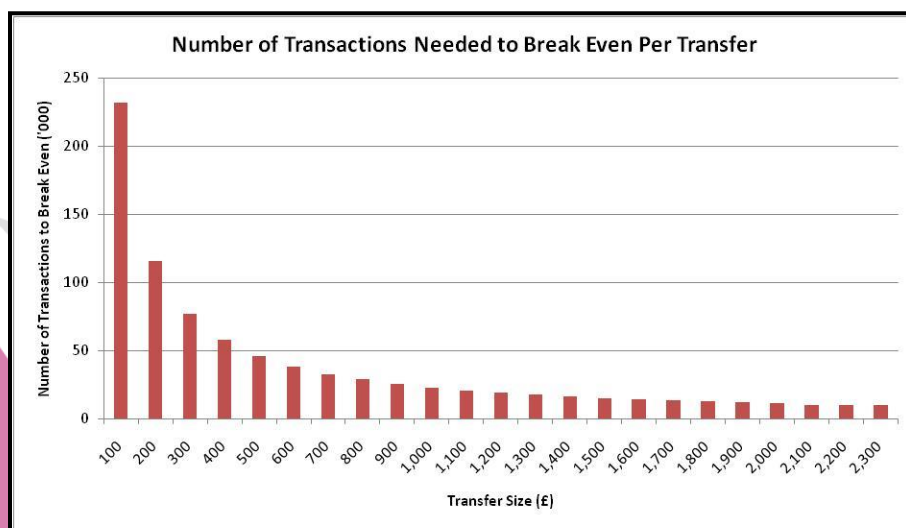

FIGURE 11: EXAMPLE OF NUMBER OF TRANSACTIONS NEEDED TO BREAK-EVEN

As the volume of transactions increases, more fixed cost capacity may be needed to process the transfers. However, usually MTOs do not operate at full capacity at all times and therefore there is slack. Up until a certain threshold the same capacity will be able to process more transactions. Should more capacity be required costs will not increase proportionally to the number of transactions; as the volume of transactions increases the fixed cost capacity necessary to process the transactions falls. This reduces the marginal cost of each pound transacted.

The example below illustrates the impact that a high volume business can have on the profitability of the MTO. In the example below, the same example as in the Agent-to-Agent Example has been used with a few amendments to reflect the high volume business.

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Assumptions:

1. ***Annual revenue increases from £1 million to £10 million***
2. ***Fixed Costs increase by four in comparison with the standard Agent-to-Agent model***

High Volume		
Revenue (£)		**10,000,000**
Home-Agent Fee		30%
Abroad-Agent Fee		20%
Bank Charges		10%
Cost of Sales		**60%**
Rent	15%	2%
Staff	45%	6%
Admin	15%	2%
IT / Telecomms	8%	1%
Marketing	8%	1%
Professional Fees	10%	1%
Fixed Costs	**100%**	**14%**
Profit		**26%**

Table 9: Assumptions for High Volume Agent-to-Agent Model

It is evident from the above example, that by increasing the volume of annual transactions by ten (from £1 million to £10 million) with an increase in the fixed costs by four times that is required to achieve this results in an increase of annual profits from 5% to 26%. The breakdown of annual revenue for the high volume business in comparison with the standard model is displayed in Figure 12.

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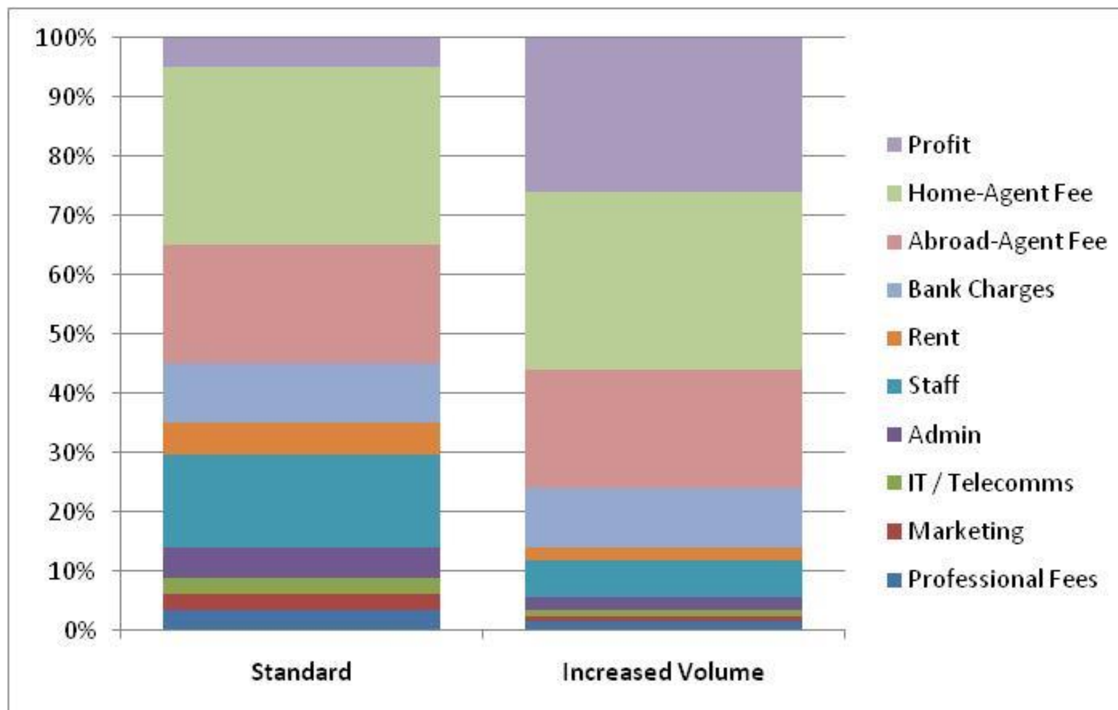

FIGURE 12: COMPARISON OF STANDARD AND HIGH VOLUME AGENT-TO-AGENT MODEL

ii. **MTOs batch funds together to reduce the marginal cost of the foreign exchange transaction**

In the end-to-end value chain of processing a transfer the information about a transfer and the actual transfer of money to do not need to happen in sequence or simultaneously. Information about a transaction will often happen almost immediately, whereas the actual transfer of funds can take a lot longer to settle.

At some stage the money deposited at the send-end actually needs to be transferred into the foreign currency and the payment settled. This is either done via:

1. A UK based bank international transfer
2. By depositing the money into a foreign bank based in the UK that will process the foreign exchange transaction
3. A wholesaler.

The advantage of the MTO model rather than the bank model is that it allows for MTOs to batch the transfers together. Transfers in the UK accumulate over a period of time and then the international foreign exchange transaction can be made in one lump sum. Given that banks use a flat rate to make a transaction, the larger the amount being transferred in one payment the smaller the fee proportionally.

Large MTOs that transfer large volumes of transactions can therefore stand to benefit substantially from the batching of funds. The larger the volume transacted, the lower the marginal cost of each pound exchanged.

Some of the difference between the fees charged to send with an MTO and the fees charged to send money through a bank can be attributed to the batching of funds - in a bank each transaction is processed individually and the information and the payment are processed at the same time.

iii. **MTOs and Banks can net foreign currencies against one another to reduce the marginal cost of the foreign exchange transaction**

For operators that deal in corridors where there is a two-way flow of money transfers, then the MTO will not only benefit from the batching of funds, but also from "netting" the balance of transfers against one another.

For example, if £100,000 is needed to be sent to the USA at an exchange rate of £1:USD1.50; and USD 150,000 needed to be converted into pounds, then the net of the two transfers would balance and no actual money transfer would need to take place. This would therefore remove the international money transfer entirely and any fees and foreign exchange spreads that the MTO would usually be liable to pay. It should be pointed out that remittance flows out of the UK are at a ratio of 4:1 compared to funds received and mostly the currencies don't match so this option is quite limited.

MTOs that operate in a single corridor where the majority of the currency flow is in one direction (for example in the UK to Ghana corridor where the Bank of Ghana does not allow MTOs to remit funds to the UK) will not be able to benefit from the netting of funds. This is the most common situation in the UK.

Both the batching and netting of foreign exchange transactions allows the MTO to reduce the costs of money transfers. By enabling the information with regards to the transaction to be handled separately from the actual money transaction, the MTO is able to process transactions for a lower marginal cost. As the volume of funds increases in both directions, the benefits to the MTO increase. Foreign exchange charges become a smaller part of the process. Large international MTOs are able to both batch and net transactions and therefore have a lower marginal cost per transaction.

Typically, what makes MTOs attractive in relation to alternative methods of transfer (such as the banks), is that they only settle the foreign exchange balance when they need to. Frequently they negotiate advantageous fee rates.

Whilst it may be logical for businesses to look to increase the average transaction value (atv) the current trend, particularly in the current economic climate is for the atv to reduce. Ultimately the sender can only send the amount of money that is available to them. This should be kept in mind when trying to develop strategies to increase average transaction value.

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4. How Costs vary between Different Types of MTO and Banks

It is evident from the examples of the MTO and banks in Section 5.2 that cost structures vary significantly depending on the different type of business model and size of the operation.

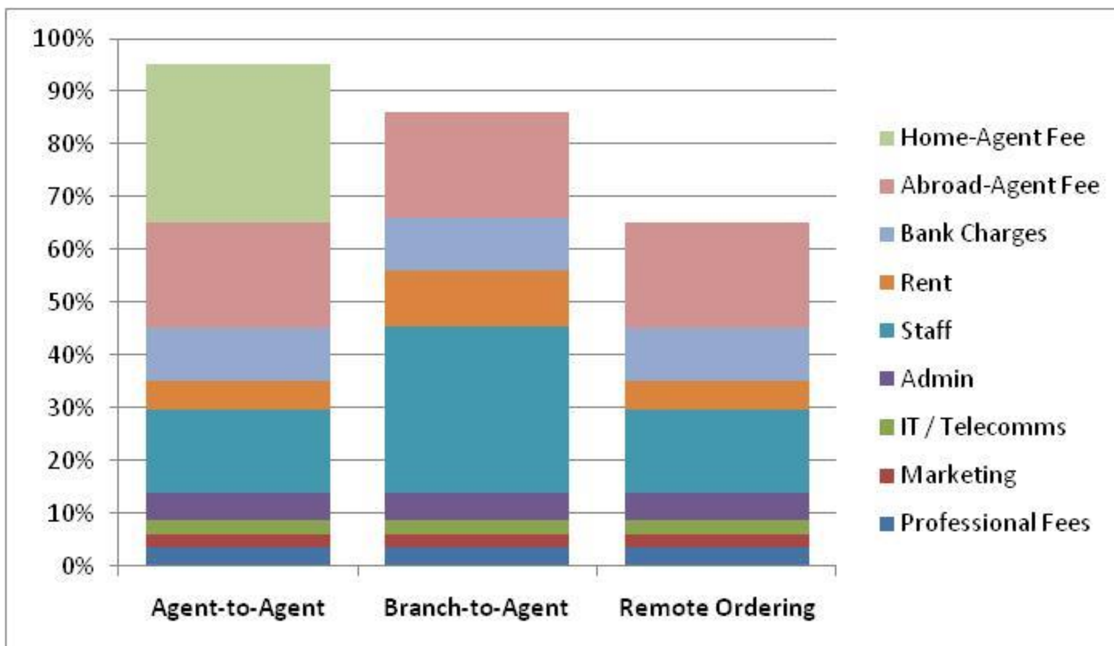

Figure 13: Comparison of Different Cost Components Across Models

Figure 13 gives a summary of the breakdown of revenues for the three most traditional money transfer services offered in the UK market. Figure 14 shows the opportunity for profit in each of these business models. What is immediately clear is that the profit margin for the agent-to-agent model is extremely low at 5% of total revenue due to 60% of revenue going on the cost of sale – the amount paid to the Send and Receive agents.

In the branch-to-agent model, despite the higher fixed costs from double the number of staff and double the cost of rent, the profit margin is 14% compared with the 5% in the agent-to-agent. This clearly illustrates the significant impact on profits in removing the home-based agent. To illustrate this point further, in the final example, where the sender conducts the transaction electronically via telephone or online, the profit margin increases from 5% to 35% of total revenue.

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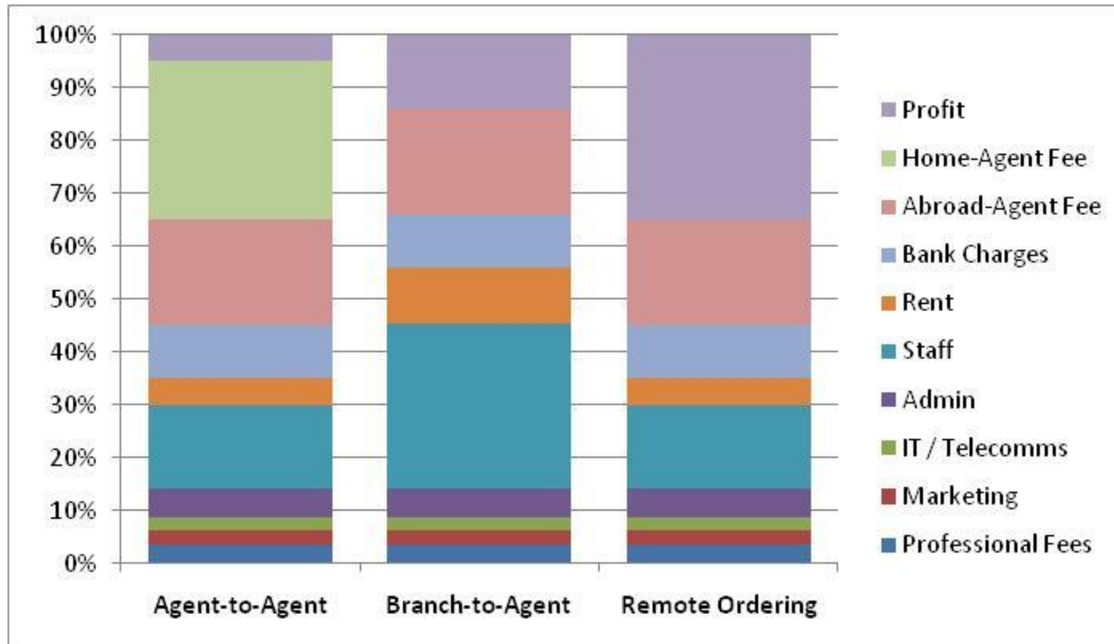

FIGURE 14: COMPARISON OF PROFITS ACROSS BUSINESS MODELS

Whilst the models are only illustrative, they show that by encouraging senders to make transfers remotely, thereby cutting out the need for either a home-agent or branches, there should be an increase the share of profits.

Having said this there is currently a preference for using an agent among the Diasporas in the UK as this is a method that they know and trust and in a number of cases is the only option open to them.

In the above illustrative examples it is assumed that the revenue generated is the same throughout the models (at £1 million per annum). Whilst this is realistic in that MTOs typically charge the same for each type of transaction, it is necessary for the MTOs to make the same volume of transactions in order to make the proposed profits. At present, UK operators do not feel that they will be able to bring in the required volumes remotely to make this a feasible business option.

It is evident from analysing the cost structures of the different business models, that there is little room to reduce costs in the agent-to-agent business model. This means that if the G8's targets are to be met (in the UK) there has to be some change in the behaviour patterns of the Diasporas and the business models they chose to use.

Whilst many of the UK MTOs do offer remote services, few pass on the cost saving to the customer. Thus there is currently no incentive for the sender to use remote ordering as opposed to the traditional agent model. MTOs should be encouraged to pass on the cost savings to the consumer to incentivise consumers to adopt these new technologies and encourage a shift in consumer behaviour patterns.

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All of the operators interviewed that use the traditional agent-to-agent model, irrespective of their size, agree that the UK market is extremely competitive. Marginal costs have been increasing overtime, due to:

- An increase in the cost of compliance (through checks, time & staffing requirements)
- An increase in regulation costs (directly through the PSD)
- Increases in the amount paid to agents

Similarly, marginal revenues have been decreasing overtime, due to the number of MTOs competing in the market on price. For small MTOs who are not able to benefit from economies of scale and high volumes of transactions, profit margins are especially tight. Some smaller MTOs are currently not able to offer competitive prices due to their internal cost structures; this is not a sustainable business model.

Due to economies of scale, larger MTOs are in a better position to deal with the competition than their smaller competitors. However, as can be seen from the quote below, the larger MTOs also recognise the intense competition in the market.

"*The markets in which we compete are very competitive and our segments face a variety of competitors. In addition, new competitors or alliances among established companies may emerge. Consolidation among payment services companies, and money transmitters in particular, has occurred and may continue. We compete for agents and financial institution customers on the basis of value, service, quality, technical and operational differences, price and financial incentives paid to agents once they have entered into an agreement. In turn, we compete for consumers on the basis of number and location of outlets, price, convenience and technology*." (MoneyGram Annual Report 2008)

With smaller agents finding it increasingly difficult to operate a sustainable business, the market may see more consolidation, as larger MTOs are able to undercut on price. In the event of market consolidation, it will be important for the authorities to regulate and monitor the market closely to ensure it continues to operate competitively.

As an alternative, successful smaller operators are seen to be able to retain customers through providing a high quality service and creating customer loyalty. In addition, by offering a more diversified and personalised service; for example offering other financial services both at home and abroad, smaller operators can differentiate themselves.

For the newer online businesses, there seems to be considerable scope for both growth and profit. According to one online service provider, that offers other complementary online services as well, the remittance side of the business is the fastest growing and catering to this growing market is of high priority to the growth of the business.

Whilst the consolidated financial statements mean that it is not possible to differentiate income streams and associated costs it is fair to attribute their profitability, in part, to the complementary services that ensure a flow of currency in both directions.

Another area where costs could be reduced is the area of bank charges. As previously discussed these are particularly significant and measures that reduce them from an operators view are worthy of further detailed analysis by MTOs.

What is evident from the UK MTOs who only provide online services is that the fees that they charge for the transfers are significantly less than those offered by other service providers. Whilst it is obvious that online operators have lower overheads (by automating so much of the process they cut out the need for staff), it is interesting to note how much lower the fees and charges are in comparison to more traditional MTOs and banks. This infers that the costs are dramatically reduced which enables them to undercut the market price significantly and still make a profit.

All parties involved in the provision of new technology money transfer services stressed the importance of education and in marketing their products effectively to ensure potential customers are aware of the variety of services available to them. Generating awareness, building trust and teaching communities of the new technologies and products in the market is key to the transformation and development of the sector.

i. Technology

If employed effectively technology has the potential to reduce costs for many MTOs. Many of the smaller MTOs still use a largely manually driven transaction process which is labour intensive. Measures could be introduced which would automate elements of this and reduce the requirement for so many staff members. As staff costs can account for up to 50% of the total costs for an operator savings in this area would have a significant impact on the bottom line of many MTOs.

In addition to the automation of existing processes, the use of new technologies that may be required to adopt a different transfer model, e.g. online, mobile etc. has the potential to reduce both fixed and variable costs. The impact will clearly depend on the current method that is used. However, technologies that reduce the reliance on agents, reduce the reliance on cash being credited to MTOs accounts, reduce the reliance on receive end agents or reduce the requirement for staff will provide the opportunity for major savings to be made.

It would be dangerous, however, to assume that the greater use of technology is a panacea for reducing remittance prices. The consumers of remittances require a high investment in customer service which often translates in being able to talk to or see the person to whom they are entrusting their money. Whilst some of the elements of customer service can be automated this will require a significant investment in communication and education.

5. What is the cost of compliance, risk management, fraud, operations management, etc?

Most of the MTOs operating the agent-to-agent model advised that they found the cost of compliance, risk management and fraud to not be overly burdensome. MTOs of all sizes appear to bear the risk that their business could have with considerable responsibility and have put in place the necessary precautions to insure against fraudulent activity and ensure KYC is conducted properly.

The number of compliance officers in an MTO typically depends on the size and type of business. On average, MTOs operating using the agent-to-agent model have one Compliance Officer for every 20 members of staff. For more automated online service providers, this proportion is higher. In large MTOs the Compliance Department is a large team and, according to those interviewed, is the fastest growing department in their business.

The PSD has only been in place since November 2009 and it is too early to be certain of the impact on the cost of operating a MTO. However, based on interview feedback and other analysis it can be concluded that the PSD will lead to an increase in regulatory related costs for all operators.

There are currently approximately 450 Small PIs registered with the FSA and around 50 Authorised Payments Institutions.

i. Small MTOs

The cost of compliance is relatively higher for the smaller Authorised MTOs than the larger ones. Given that the remittance business is a volumes game, this will further disadvantage the smaller operators. Government should monitor this to establish whether the competitive dynamics in the market change as a result of the regulation.

Small MTOs operating in a single corridor find the cost of compliance the least cumbersome as they are only dealing with regulations in the UK and the receive country. Most deem the current regulatory requirements a "necessary evil" and have implemented systems that automatically track transactions and flag customers whose transactions have reached the transfer limit.

Furthermore, the PSD requires that the MTO takes responsibility for their agents. At present the cost of registering an agent in the UK is £120 per annum. However, according to some estimates, by operators, the cost of supervising an agent is estimated to be as much as £1,000 per month under the new PSD regulations. If this is the case, it is an additional expense to MTOs that are already operating within very fine margins.

ii. Larger MTOs

Some of the larger MTOs complain that there is not a level playing field in the UK's regulatory market, by claiming that the lack of enforcement of the regulations by the FSA means that some of the smaller

operators are getting away with not complying with regulations whereas the larger operators spend a considerable amount of resources assuring compliance requirements are met to avoid the large penalty fines. The record of HMRC in prosecuting non-compliance with regulations has not engendered confidence of all those businesses that are operating in a compliant manner. Other countries, most noticeably the USA, have a far stronger record of prosecuting non-compliant businesses and it is recommended that lessons are drawn from this.

For large MTOs the cost of compliance is exacerbated due to the number of different regulatory environments in place around the globe. For large MTOs operating in numerous corridors internationally, the complexity in making sure that they adhere to all the different regulatory requirements internationally is an ongoing challenge. For example, India has a system where senders are only allowed to complete a maximum of 12 transactions per annum or to a centrally set total value.

Additionally, the number of people that are on the US's watch-list (predominantly from the Middle East) means that the MTOs have to build in a number of safeguards to meet these requirements.

Changes in one jurisdiction have a knock-on effect into many different areas of business such as legal status, VAT treatment, tax liability, marketing, ring-fencing funds, reporting requirements etc. One MTO suggests that a single change in regulation can touch as many as 15 different aspects of the business. These examples indicate the cost implications of regulatory changes within an international arena. There is therefore a request from MTOs operating for there to be a harmonisation of regulations internationally. Some even state that the level of regulation would not be problem provided there is more harmonisation. In addition, this would help software developers to automate more of the process and thereby reduce costs. The PSD will achieve regulatory harmonisation within Europe and is therefore welcomed by the operators.

There is a cost involved with becoming authorised through the PSD that will mean that only the larger MTOs will do this. The increased costs of meeting the requirements of the PSD, including the safeguarding of funds, will be balanced by the ability for Authorised PIs to operate in additional markets in Europe. Small PIs will benefit from lower requirements and fees but will miss out on the opportunity to operate in other European markets.

iii. Bank Charges

Whilst some of the smaller MTOs do not deem the direct cost of compliance as a burdensome to their business, most complain of the bank charges that they incur through their business. It is evident from talking with banks, that inherent in their charges is the cost of compliance that the FSA puts on banks in processing money transfers made by MTOs or in managing MTO accounts. Due to the high risk of fraudulent activity and the requirement for additional KYC and AML issues, banks make sure that all MTOs go through a series of rigorous checks. Therefore, the bank charges not only represent the cost of cash handling to the bank, but also reflect the auditing and checks that the banks have to undertake on the MTOs. It is the cost of compliance through the bank charges that the smaller MTOs find most burdensome.

MTOs that become Authorised PIs should represent a lower risk to banks than Small PIs and therefore it is anticipated that banks will reduce the fees that they charge to these businesses.

Cost of Compliance for Banks

As has been covered elsewhere in this report there is a high burden of compliance on banks in terms of KYC on all their customers regardless of the services that they use. Banks have extensive compliance teams which operate at arms length from their customer facing divisions. In order to open a bank account the consumer must provide at least two forms of identification, one of which is a photo ID and the other will be a proof of address. The bank will also make a series of background checks.

Banks in the UK address their KYC concerns in respect of remittances by only offering international money transfer services to their own customers. In practice this is effective in controlling the KYC risks but does limit customer choice. A number of remitters do not hold a bank account and therefore do not have the option of using a bank and must use a non-bank MTO instead.

In addition to the KYC restrictions banks also have highly sophisticated automated systems to screen transactions and to look for trends in international payments. They also have large compliance teams. Whilst banks were unable to quantify the exact costs of compliance in respect of remittance transactions they did indicate that this was a significant cost component in their pricing of international payments.

Other Countries' Regulations

The scope of this project did not allow for a thorough comparison with other similar countries regulatory environments and this may be a useful future exercise. However, experience of the research team in the legal framework in a number of other key markets such as USA and Europe (including key send markets of France, Germany, Spain and Italy) shows that the broad principles around registration and KYC are similar across these markets. Indeed all of the European markets are now operating under the Payments Services Directive and the Anti-Money Laundering Directive. Interpretation of the AML regulations is slightly different from country to country and in many of the other European countries there are more restrictions and greater requirements on money transfer businesses. The UK has deliberately adopted a 'light touch' approach to regulation as the government considers that this will prevent businesses driven underground through their lack of desire or inability to comply. Evidence for this can be seen in the large number of operators in the UK prior to the PSD, approximately 2800, compared to around 60 operators in Spain, less than 10 non-bank operators in France and only 40 in Germany.

In Europe there are still 10 of the 31 countries that are covered by the PSD that have not fully implemented the Directive and therefore it is difficult to make cross-country comparisons at this stage. The PSD, whilst it is a maximum harmonisation directive does allow for some local variation in a few areas and the exact nature of these for all countries will become clearer over time.

In the USA each state has its own regulatory requirements. For an operator to be present in every state they will need to complete a registration/regulation process in 48 states. This is a costly and lengthy process. The approach varies from state to state but as a generalisation the principles are broadly consistent and are somewhat similar to the environment in Europe.

Thus, whilst the regulatory approach in many key send markets is broadly consistent there are local nuances in every country which means that businesses that operate in more than one country require additional legal support, which is often provided in-house, to be able to meet these complex requirements. This can add significantly to the cost base because as well as the regulatory and AML framework businesses must be certain of the consumer protection, data protection, tax and company law in each market.

As a conclusion, the UK has a lighter touch approach than many other markets but the regulatory environment still requires the application of extensive resources which have an impact on the cost of a remittance service.

How do the main cost components in the UK compare with other leading countries?

It is useful to be able to compare the key costs incurred in the UK compared to other countries in order to be able to gain some insight as to why, despite the high number of operators' costs appear to be higher than in some markets such as Spain and the USA. The three main cost components are staff, bank charges and rent. By using international indices it is possible to draw some conclusions in the area of staff costs and rent. There is no such index for cash handling and other commercial bank fees. However, anecdotal evidence from discussions with MTOs and banks in the USA and Spain indicate that the fee levels in Spain are at least as high as those in the UK and that the USA sums vary depending on the state and the size of business. Overall a broad conclusion is that bank charges are slightly lower in the USA.

Country	Ave admin salary (PPP)*	Cost of living index+
UK	1376	1.240
USA	1469	1.000
France	1479	1.160
Germany	1961	1.130
Spain	1451	1.019
Italy	1204	1.042

*Source: International Salary Database 2008

+Source: International cost of living index – Finfacts 2009

TABLE 10: COST COMPARISON FOR STAFF AND COMMERCIAL RENT IN KEY COUNTRIES

Table 10 shows that salary costs for staff in the UK are similar to those in France and Spain and are slightly higher than those in the USA whilst they are considerably higher than those in Italy. This data does not reflect other elements of employment law, such as the ease with which staff can be replaced etc. There are different approaches to employment in MTOs in the countries involved, such as part time workers and the varied degree to which appropriate employment regulations are followed.

However, from a first review of this data it would appear that there is not a significant difference between salaries in many of the main countries.

The cost of living index does indicate that the UK is considerably more expensive place to operate a business from than all of the other markets, especially Spain and Italy. Whilst this is proxy data it does support a hypothesis that the UK is a more expensive country and this may partially explain why UK prices are at the level that they are.

However, whilst on balance it may be more expensive to operate in the UK than many other key send markets the interviews with operators revealed that some are conscious of the profit per transaction many are pricing their service based on the price of their competitors regardless.

As a conclusion, costs in the UK are somewhat higher than some of the directly comparable countries.

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RECOMMENDATIONS

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6. Recommendations

I.	Explore options to change business model and remove the Agent and Pass on Costs to Consumers		
Explanation	The send-agent takes a significant proportion of revenues and in addition, through the MTO is also responsible for registering and managing the agent. By cutting out the send-agent through adopting new technologies (such as remote ordering online), the MTO can reduce their cost of sale. The MTO can at this stage pass the cost saving to the consumer. At present there is usually no financial incentive for the sender to transact remotely. By offering a lower fee for the reduced cost services MTOs will incentivise customers to change their behaviour patterns.		
Benefits	Reduced costs for MTOs. Reduced fees for senders.		
Ownership	UKMTA / IAMTN / DFID to educate UK based MTOs	Relevant Section	Section 5.4 – p.60

II.	Automate Systems		
Explanation	At present one of the main fixed cost components for MTOs are staffing costs. By automating more of the systems this will reduce the need for staff.		
Benefits	Reduced costs for MTOs. Reduced fees for senders.		
Ownership	UKMTA / IAMTN / DFID to educate UK based MTOs	Relevant Section	Section 5.4 (i) - p.63

III.	Educate the UK Diaspora about new transfer methods		
Explanation	There are a number of new transfer methods available in the UK market that would significantly reduce the cost of sending money overseas. The UK-based Diaspora needs to be educated to learn that the new technologies are cheap, safe and simple.		
Benefits	Reduced fees for senders.		
Ownership	UKMTA / IAMTN / DFID	Relevant Section	Section 5.4 - p.60

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IV.	Work with developing country Governments to improve financial infrastructure & regulation		
Explanation	There are a number of new transfer methods available in the UK market that would significantly reduce the cost of sending money back home. In addition the fees for the receive agent constitute a significant proportion of costs, so by removing the receive agents, costs would fall. In addition, the current cash based system is expensive due to the security risks. Therefore by adopting new transfer methods, the cost of send will fall. Despite the new methods that are available that reduce costs and/or new methods that remove the need for an overseas-agent, at present many of them cannot be used in the UK to developing market corridors due to the weak financial infrastructure, regulation and security in the foreign country. By helping developing countries improve their financial infrastructure, UK-based senders will be able to reduce their send costs.		
Benefits	Reduced fees for senders.		
Ownership	DfID, Foreign Governments, G8 Remittances Working Group	Relevant Section	Section 5.2 – p.38

V.	Diversification of Products and Services of MTOs		
Explanation	It is clear that for many UK MTOs the market is extremely competitive; especially the smaller operators. Given that the marginal cost of each transaction falls as the volume of transactions increases, it follows that the larger MTOs that benefit from increased economies of scale are at a comparative advantage in the traditional agent-agent model. To ensure that the smaller MTOs do not have to leave the market, or are forced to start operating informally, small MTOs should be encouraged to diversify the range of products and services they offer and differentiate their services on other factors aside from price. Options include: providing additional financial services for the UK based Diaspora and the recipient in the receive country / offering a high quality and reliable service in niche corridors.		
Benefits	Maintain healthy competition in the market		
Ownership	DFID / FSA / IAMTN / UKMTA	Relevant Section	Section 5.3 – p.56

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VI.	More competition in the bank market for MTOs		
Explanation	At present over 70% of MTOs registered in the UK bank with one bank. Furthermore, most MTOs attribute bank charges to be their most burdensome cost component. The bank market for MTOs is extremely uncompetitive. The FSA/Treasury should investigate why this is the case and make recommendations to ensure greater competition.		
Benefits	More competition in the market is likely to reduce bank charges overtime and therefore reducing the cost of sales for MTOs and hopefully reducing the fees to consumers in turn.		
Ownership	FSA & EU	Relevant Section	Section 5.1.3 – p.27

VII.	Authorised MTOs should get reduced bank costs		
Explanation	The new Authorised PI under the PSD requires a high level of auditing, reporting, compliance, protection and insurance and a high level of scrutiny by the FSA. The banks state that one of the main reasons that their bank charges are so high is because they have to spend a lot of resources checking and monitoring the MTOs. For Authorised PIs the level of checks and monitoring and perceived level of risk should be less. This cost saving should be passed onto the Authorised PI by the bank in the form of reduced bank charges.		
Benefits	Reduced bank charges would reduce the cost of sales for Authorised PIs and help to negate against the additional costs that authorisation requires. This cost saving should be passed onto the consumer in a competitive market.		
Ownership	FSA and Banks	Relevant Section	Section 5.1.3 and 5.1.4

VIII.	A Level Playing Field: Better Monitoring of MTOs and Enforcement of the Regulations		
Explanation	The authorities have been criticised by some of the MTOs operating in the market for not monitoring and upholding the regulations that they have put in place. Given that the new PSD is expensive and is fairly stringent in its requirements, MTOs are requesting that the Authorities dedicate more resources to making sure that all operators are adhering to the rules and to prosecute those that do not.		
Benefits	Helps to create fair competition in the market. In the long-run this should improve the quality of services and reduce the price of remittance services.		
Ownership	FSA	Relevant Section	Section 5.1.4 – p.29 and Section 5.5 p 64

IX.	Educate the UK based Diaspora about the Benefits of the PSD		
Explanation	The PSD is an added expense to MTOs operating in the UK. Therefore, there should be some additional value that MTOs receive for their investment (especially in the case of Authorised PIs). By educating the Diaspora about the positive benefits of using a registered or authorised PSD this will reduce the existence of operators that are not registered that can offer better prices.		
Benefits	Helps to create fair competition in the market. In the long-run this should improve the quality of services, reduce the price of remittance services and remove informal operators from the market.		
Ownership	FSA / UKMTA / IAMTN / DIFD	Relevant Section	Section 5.1.4 – p.33 and Section 5.5 p 64

X.	Harmonisation of Regulation Internationally		
Explanation	Whilst the UK regulation itself is not considered overly burdensome, the complexity and heterogeneity of international regulation on remittances is considered to be extremely cumbersome to UK based agents affecting costs and preventing them for developing new transfer methods across countries. The new PSD is welcomed as the first steps toward a more harmonised regulatory environment; however, MTOs would like to see total harmonisation internationally.		
Benefits	Make more innovative transfer solutions available. Increase automation in the system. Reduce costs.		
Ownership	FSA & EU	Relevant Section	Section 5.1.4 – p.33 and Section 5.5 p 64

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APPENDICES

Appendix I – About DMA

Background to DMA

Developing Markets Associates Ltd (DMA) is an expert development consultancy specialising in the fields of migrant remittances, inward investment programmes and international development events. DMA's management team has over 30 years experience within the remittances and international development arena and has undertaken numerous highly acclaimed projects and events as well as having advised a number of governments on developing remittance programmes and optimising inward investment flows.

DMA was officially incorporated in February, 2007 and has undergone a sustainable and healthy growth to become a respected and highly effective company in its fields of operation. DMA opened its first international office in Sydney, Australia in October, 2008.

In the area of remittances, DMA carries out the following activities:
· Remittances consultancy: undertaking a range of bespoke consultancy projects for government and donor agencies including an in-depth study into the linkages between remittances and financial inclusion in the UK; mystery shopping exercises to test remittance transactions and gather price data; as well as developing remittances information resources to assist migrant communities. DMA also undertakes consultancy for the private sector, covering both those organisations that are looking to grow their money transfer businesses and those with new products who wish to make an initial entry into the industry.

· Remittances information: the provision of consumer relevant information via websites, leaflets, media coverage including print, new media, radio and television, and face-to-face communication.

DMA run and host three remittance based websites:
www.moneymove.org – a remittance customer price comparison site that uniquely contains all the relevant costs for a consumer including foreign exchange costs, receiver fees and documentation required at the send and receive end, and where the money can be collected. This is then entered into a database which calculates the total cost to consumers. The site lists the companies that have been surveyed and ranks them in order of best value, speed, fees levied, exchange rates etc. The site currently covers 22 corridors from the UK, including Ghana, and, unlike other information Technical Submission and Capability statement Page 3 of 10 Private and confidential resources, includes all of the main companies that are sending money to each country. In the case of the UK to Ghana corridor, it lists 32 key MTOs and banks that offer a service which accounts for over 80% of the formal market to Ghana.
www.sendmoneypacific.org – this site, which was launched in March 2009, was commissioned by the Australian and New Zealand Governments to help bring greater transparency to remitters who send money to the Pacific Islands. The programme requires a detailed understanding of how remittances

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work to the development of effective mechanisms to disseminate information to the relevant community groups.

www.dmassocs.com/dril – an on-line bibliography of over 500 reference sources on remittances. This is a DfID funded site which was established to act as a central repository of information for the remittance industry, academics, research companies, journalists, the donor community and governments. DMA were responsible for building the online database and are responsible for its updating and global promotion.

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Appendix 2 – MTO questionnaire

SURVEY

Questionnaire – Supply side constraints for remittance operators

Please note that the answers to this questionnaire will be kept **totally confidential** and will not be attributed.

Name Organisation	
Type Organisation	
Number of Branches	
Number of Countries Operating in	
Number of Employees	
Number of Agents	
Which bank do you bank with?	
Who are your main competitors?	

What type of business models do you operate? (Please mark all those appropriate to you using an X)

Cash-to-Cash (Agent / Franchise Model)	
Own branch-to-Cash	
Remote ordering by customer in UK (by phone/internet for cash collection (Phone / Online)	
Cash-to-bank account in receiving country	
Pre-paid cards	
Other (please specify):	

Section 1: Fees

Do you have different fees for different corridors?

Yes [ ]   No [ ]

Do you have different fees for different services offered?

Yes [ ]   No [ ]

If yes, what determines the differences in fees? (Please rank where 1=main reason and 7=least reason cited)

		Rank
1	Volume in the Corridor (More volume; lower costs)	
2	Costs in the foreign country (Higher costs; higher costs)	
3	Compliance costs in foreign country (high bureaucracy; high costs)	
4	Exchange rate volatility in foreign country (volatile; high costs)	
5	Cost of agents in the UK market (high costs; high costs)	
6	Cost of agent / distribution network in foreign country (high costs; high costs)	
7	Relativity to fees charged by competitors	

How do you generate revenue (Please enter estimates of the % of your total revenue)

1	Fees paid by Customer	%
2	Foreign exchange fees paid by Customer	%
3	Foreign Exchange spread	%
4	Interest on float	%
5	Investments of capital	%

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6	Other (please specify)	%

Section 2: If you use agents in the UK:

How much do you typically pay an agent? (% of amount sent or fixed fee per transaction? Do you share foreign exchange earnings?)

Please tick the most appropriate? (X)

1	Agent fees are standard across the board	
2	Agent fees vary according to negotiation / desirability of location	

What determines the level that you pay your agents in the UK? (Please mark all those appropriate using an X)

1	High volume corridor with high competition between agents – drives up cost of agents	
2	Relativity to fees paid by competitors in the market	
3	Area, visibility & site of the agent's premises	

Section 3: If you use a partner / agent in the foreign country:

Do fees/commissions paid abroad vary according to the country?

Yes [ ]   No [ ]

What determines how much you pay for the receive network? (Please rank where 1=main reason and 5=least reason cited)

1	Your volume in the Corridor (more volume; pay less)	

2	Costs in the foreign country (high costs; pay more)	
3	Compliance costs in foreign country (high bureaucracy; pay more)	
4	Competition in the agent network in foreign country (high competition; pay more)	
5	Relativity to fees charged by competitors	

Section 4: Costs

What is your annual revenue (roughly)?

What are your main cost components? (Please indicate as a rough % of your total costs)

Rent	%
Employees	%
Agent fees (home)	%
Banking Costs	%
Foreign network fees / commission	%
Compliance Costs	%
Marketing	%
Admin	%
Hardware & Software development	%
Other (please specify)…	%
	100%

How many transactions do you process per annum (roughly)?

Are fees charged by UK banks to process the transaction burdensome?

Yes [ ] No [ ]

What do you find the most burdensome costs?

Where do you think costs could be reduced?

Section 5: Regulation

How many compliance officers do you have?

Roughly (on average) how many forms do you have to fill per transaction? Does this depend on the receive-country?

Do you consider compliance in the UK to be burdensome? Can you estimate the total cost of compliance to your business. How could this be improved?

Thank you for your time!

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Appendix 3– Regression results

Table 3. Regression Results: Determinants of Transaction Costs

Explanatory Variables	(1)	(2)	(3)	(4)	(5)
Bank Concentration	0.05** (2.29)	0.03 (1.10)	0.03 (1.35)		
Financial Development	-0.05** (-2.41)	-0.05** (-2.38)	-0.05** (-2.42)	-0.06** (-2.54)	-0.05** (-2.53)
Financial Risk	0.04 (0.32)	-0.04 (-0.26)	0.03 (0.24)	-0.04 (-0.31)	0.01 (0.02)
Dollarization	-4.12** (-4.47)	-3.92** (-3.87)	-3.92** (-4.20)	-4.10** (-4.14)	-4.00** (-4.33)
Domestic Output	-0.22 (-0.46)	-0.56 (-1.02)	-0.32 (-0.66)	-0.75 (-1.47)	-0.46 (-0.98)
Remittances		-0.30 (-1.18)		-0.42* (-1.85)	
Stock of Migrant Workers			-0.34 (-1.18)		-0.59** (-2.40)
R-Squared	0.52	0.56	0.53	0.52	0.52
Number of Observations	76	69	76	70	78

Robust t-statistics in parentheses.
**Significant at the 5 percent level.
*Significant at the 10 percent level.

Source: Freund and Spatafora (2005c)

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Appendix 4– PSD Requirements for Small PIs and Authorised PIs

Small PI

To qualify for registration as a small PI, your firm must meet the following conditions:

- Average monthly payment transactions (over the preceding 12 months) must not exceed €3million;
- None of the individuals responsible for managing the business has been convicted of offences relating to money laundering or terrorist financing or other financial crimes;
- head office, registered office or place of residence must be in the UK; and
- Comply with the registration requirements of the Money Laundering Regulations 2007, where those requirements apply to it.

Authorised PI

If you do not qualify as a small PI, or you wish to passport into other EEA States, then you will need to apply to become an authorised PI.

You will need to give detailed information about your payment services business, including, among other things:

- Details of the payment services business you carry out;
- The governance arrangements and internal procedures in place;
- How you will meet the capital requirements (see Chapter 9 of the Approach Document for further information);
- Details of the individuals responsible for payment services; and
- Details of any persons with qualifying holdings.

The level of detail provided in the application should reflect the size and complexity of your business.

These fees appear costly however once an application is approved as an Authorised PI a company can operate within other European countries covered by the directive, thus reducing further admin and registration costs in those countries.

Beyond the initial registration forms, companies registering as Authorised PIs must also complete forms for any individual person or company with stakes in the company.