



The Fair Exchange: Improving the Market for International Remittances

Executive Summary

International remittances from the United States to Mexico and Latin America are continuously increasing paralleling the large growth in Latino immigrant communities in the United States. A recent report from the Inter-American Development Bank estimated that remittances from the United States to Latin America, primarily sent by migrants to their family members abroad, reached \$45 billion in 2006, an increase of \$5 billion from 2005.¹ The growing importance of international remittance markets, both as a business and an economic development opportunity, has drawn policy and research attention in recent years. Policymakers, market participants and researchers have recently focused attention on how to reduce the costs and improve the transparency of pricing of international remittances.

In the 2001 Partnership for Prosperity between the United States and Mexico, both countries focused on cooperation to reduce the cost of international remittances as an important joint policy goal. The 2004 Summit of the Americas in Monterrey, Mexico also affirmed the goal of reducing remittance costs in the Americas. A report from the spring of 2006 showed that prices are likely coming down. From 2000 to 2005, the average cost of sending \$200 from the United States to Latin America fell from 10% of the transaction amount to 5.6%.² However, more can be done to reduce costs and improve price transparency, to assist consumers in comparison shopping for remittances. With existing disclosures it is often hard for consumers to understand, before they engage in a transaction, the full costs of sending a remittance, including transaction fees and the exchange rate spread, the difference between the exchange rate offered to the customer and that obtained by the remittance firm.

Recent studies by the World Bank have noted the importance of transparency in international remittance markets. A January 2007 report, entitled *General Principles for International Remittance Services*, listed as the first general principle, "The market for remittance services should be transparent and have adequate consumer protections."³ A 2005 Appleseed study of the U.S.-Mexico remittance market highlighted challenges consumers face in determining and comparing exchange rates and fee pricings for low-dollar international remittances to Mexico across service providers. A major finding of the report, in line with the World

¹ Inter-American Development Bank and Multilateral Investment Fund. *Sending Money Home: Leveraging the Development Impact of Remittances*. October 2006. p.4.

² Manuel Orozco. "International Flows of Remittances: Cost, Competition and Financial Access in Latin America and the Caribbean—Toward an Industry Scorecard." *Inter-American Dialogue*. May, 2006. p. 2.

³ *General Principles for International Remittance Services*. Committee on Payment and Settlement Systems. The World Bank. January 2007. p.21.

Bank's principles, was that the international remittance market could benefit from consistent, accessible, and comparable pre-transaction pricing disclosures.⁴

As part of a new approach to implementing consumer disclosures, Appleseed and its partners launched the Fair Exchange effort in April of 2006 to explore the possibility of creating a market-based initiative for providing improved pricing disclosures in international remittance markets, similar to the Fair Trade branding of coffee. The premise of the initiative is that offering clear pre-transaction disclosures for remittance transactions could increase the market share of participants, benefiting competitive players and consumers alike. By highlighting pricing up front, market participants would publicly signal that they are interested in dealing with customers in a forthright manner. Voluntary disclosures could help to improve the public image of the participating firms. Moreover, the Fair Exchange process would help to create a forum for industry and consumer representatives to engage in positive and creative dialogue and joint initiatives with the goal of producing mutually beneficial market solutions to other relevant issues. As part of the process of developing a market-based voluntary disclosure program, Appleseed convened the Fair Exchange Committee, including representatives of the international remittance industry, banks, credit unions, federal and state regulators, and consumer advocates. Appleseed has worked with the committee to develop approaches for pre-transaction disclosures and for a Fair Exchange program.

This report summarizes the findings of the Fair Exchange process in three areas:

- model **consumer disclosures**, which underwent focus group testing in immigrant communities;
- models of **voluntary industry standards**; and
- a fair exchange **program and disclosure template for piloting**.

Focus Group Testing of Consumer Disclosures

For consumer disclosures to work, consumers need to understand them. The Fair Exchange developed disclosure models after extensive discussion with experts, and then tested the models through focus groups in four immigrant communities with a total of fifty participants. The first section of the report presents the results of consumer focus group testing of pre-transaction disclosure template developed through discussions with the Fair Exchange Committee.

Four focus groups were held in Chicago, Illinois; Atlanta, Georgia; Lincoln, Nebraska; and Austin, Texas. The groups included people who regularly remit money to family members in seven countries in Latin America, with the majority remitting to Mexico. They also included variations in gender, age, education, and income:

- The majority of participants had monthly incomes of \$2000 or less;
- One-quarter had only an elementary school education, while 42% had a middle school or high school level education;

⁴ Appleseed. *Creating A Fair Playing Field for Consumers: The Need for Transparency in the U.S.-Mexico Remittance Market*. December 2005.

- Just over half of the participants sent amounts between \$100 and \$300 to family members in Latin America; and
- 65% of participants sent money at least once per month.

Through the focus groups, we strived to understand the immigrants' remittance practices and priorities and to test their reactions to the new pricing disclosure template. Participants were asked to rank a variety of factors affecting remittance transactions on a scale from most important to least important. Participants could rate more than one factor as most important. Of the factors presented, the top three were **security, reliability, and cost**. Sixty-one percent of participants ranked security as most important, 57% ranked reliability as most important, and 50% gave cost the highest ranking.

Prior to seeing the model disclosures, most participants reported that they felt they had adequate access to pricing information. Participants tended to use word of mouth as their main source of information regarding pricing and service. Those who compared prices often had to visit the locations of competing services, which they found cumbersome.

Notwithstanding their previous sense of comfort with the transaction information, when participants viewed the disclosure templates, they found them extremely beneficial. The discussions revealed that participant expectations of the marketplace were quite low. When presented with higher standards of disclosure, they quickly embraced them:

- All the participants liked the idea of a **clear, uniform, pre-transaction disclosure**. The current practice differs from firm to firm and location to location, with some locations providing various components of pricing information prior to the transaction and others only after the transaction has been completed.
- In comparing the different versions of the pre-transaction pricing disclosure template, participants chose the templates with **more detailed transaction information** rather than the simplest version.
- Participants focused on the **actual value of the funds received** by their family member in local currency in the recipient country, net of all fees to send or receive, and net of the exchange rate spread.
- The discussion revealed that **predictability of the transfer** is a high priority and that having an official disclosure helps them not only compare services, but also feel secure that the service they choose is providing a guarantee to meet their expectations.
- Participants in each of the focus groups stated that they would prefer to use a business that posted a pre-transaction pricing and service disclosure over one that did not.

As one participant shared, "I would not like just one business to use this [disclosure table], I would like all businesses to use this!"

The focus groups provide evidence that there is a market-based incentive for businesses to adopt consistent and complete pre-transaction disclosures for international remittance transactions. The results reflect the importance of remittance transactions to immigrant consumers and the multiple priorities that affect decisions to use one service over another. The disclosure templates presented to focus group participants address many of those priority issues, including information on fees, the exchange rate, date of availability, and a subset of

locations for pick up of the funds. Consumers in the groups wanted the information and expressed a preference for businesses that would provide it. The preliminary template, which represents the disclosure preferences of the focus group participants, can be used as a starting point for developing a final disclosure form. Further market testing and industry vetting, to ensure the disclosure is compatible with varying business models, are necessary to reach a final template.

Models for Voluntary Industry Standards

Section II of the report presents information on models for voluntary, market-based initiatives for implementing industry standards, similar to the Fair Trade concept. The models are designed to provide insight into how the international remittance industry could create a voluntary program for pre-transaction disclosure standards. The section explores four models that currently exist in the marketplace:

1. An **industry trade association** setting and enforcing market standards for its members;
2. A **independent non-profit organization** working to establish industry standards through **grassroots** work;
3. A independent non-profit organization **setting and enforcing standards for industry**; or
4. **Individual businesses** setting internal standards for investments, suppliers, or agents.

Each of these models could be applicable to a market-based pre-transaction disclosure initiative. Appleaseed worked with the Fair Exchange Committee in order to target the most appropriate models in the context of the current international money transfer industry environment.

A Fair Exchange Program

The final section of the report provides approaches to a Fair Exchange program proposed by Appleaseed and based on feedback from the Fair Exchange process. Designing a market-based disclosure initiative for international remittance businesses has two key components:

- developing **participation standards** and
- developing an **administrative framework** for the initiative.

The Fair Exchange Committee proceedings pointed to minimum market standards that take into account key barriers to disclosure raised by industry participants in the committee and that could be implemented in the current market environment:

1. **Pre-transaction Disclosure.** A pre-transaction disclosure, such as the preliminary template developed through focus groups and committee proceedings, will be provided to each money transfer retail location for the top three paying agents⁵ in the top three destination countries;

⁵ A paying agent is the agent that disburses the funds sent through a money transfer business in the United States to the funds recipient in the destination country.

2. **Facilitated Complaint Resolution.** Each money transfer business must provide consumers with a phone number to call in the event of any problems with the service and the phone number of appropriate state and federal regulators; and
3. **Good Faith Compliance with Minimum Standards.** Money transfer businesses must make a good faith effort to have the pre-transaction disclosure posted in each retail location of the business.

In addition to issues around consumer disclosures, the committee discussed other concerns and opportunities that a Fair Exchange program could address. These include:

1. Working to address problems with access to bank accounts for money service businesses, including non-bank money transfer businesses; and
2. Exploring creative collaborations among banks, non-bank money transfer businesses, and consumer organizations to improve the financial inclusion of immigrant communities.

Two of the voluntary market-based industry standard models described in the second section of the report stand out, currently, as having the most potential for the international money transfer market:

1. A business setting internal standards; and
2. An independent non-profit organization setting and enforcing industry standards.

Of the two models listed above, the model of the business setting internal standards is the easiest to implement. It is low-cost and offers each business significant flexibility in implementing standards to fit its business model. The disadvantage of this approach is that it may face difficulties in gaining credibility among consumers and businesses would not benefit from a broad-based marketing campaign and collaborative advantages of being part of an organization that implements and enforces the standards.

The second approach, an independent non-profit administered program with membership based on meeting explicit standards, similar to the Fair Trade Federation, would be costly and difficult to establish. Benefits of this approach include a national branding and marketing of the initiative; credibility of the standards through enforcement by an independent body; advantages of working with other members to explore creative solutions for issues impacting both industry and consumers; and collaborating on future market-based initiatives.

This report is a preliminary step in launching such a market-based initiative. It provides an opportunity for the industry to work cooperatively with consumer organizations to achieve common goals. The next steps in the process include a limited pilot to test the disclosure in a market setting, and then expanded implementation if the pilot proves successful. A number of participants in the Fair Exchange process have agreed to pilot pre-transaction disclosure in the coming months. These pilots should lay a solid foundation for future work establishing the Fair Exchange.