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**COMPETITION ISSUES AND REMITTANCES IN LATIN AMERICA**

**-- Issues Paper --**

by  
the OECD Secretariat

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## COMPETITION ISSUES AND REMITTANCES IN LATIN AMERICA

### -- Issues Paper --

#### 1. BACKGROUND INFORMATION

1. Along with accelerating migration from Latin America and the Caribbean (LAC), the growing flow of worker remittances – money sent home by migrants abroad - has rapidly gained the attention of governments, the private sector and civil society as an important issue in development. Remittances to Latin America and the Caribbean reached nearly \$54 billion in 2005. Increasing competition in remittances markets has been identified as a means of lowering transaction costs and improving the efficiency of the market. This theme also has far-reaching development consequences in achieving national policy objectives, especially in the context of increasing financial access to the poor.
2. Although prices for remittances to LAC have fallen with competition in many corridors, there are other corridors where remittance service providers (RSPs) exercise market power, charging above market prices. While service options and quality standards have improved with new entrants, services and innovations, geographic disparities persist within and among countries depending on their financial infrastructure, as well as other factors.
3. The economics of the remittances industry, especially its geographic fragmentation and the importance of building acquisition and distribution networks, generates economic challenges for new entrants and incumbents. Structural and systemic constraints to more competitive conditions - lack of transparency, underdeveloped financial infrastructure, challenging legal and regulatory frameworks and poor financial access – may set up barriers to entry that maintain incumbent institutions' large proportion of LAC remittances markets.
4. In addition, regulatory frameworks for remittances are increasingly restrictive in developed country sending markets – often in ways that impede competition – but many receiving country distribution markets are very lightly regulated.
5. A remittance involves the use of remittance service providers (“RSPs”) at both the sending and receiving end, and intermediary correspondent banks. RSPs compete on the basis of *inter alia* prices, speed of service, and the coverage of their networks. RSPs can be money transfer operators (“MTOs”) such as Western Union or MoneyGram, a bank or other financial institution, a money changer, or a merchant such as a gas station or grocery store. Depending on the country, branch banks or other networks distribute a substantial proportion of remittances, often as agents of MTOs.

6. Different remittance markets raise different competition issues. In some, there are multiple competitors providing comparable services and consumers can and do switch providers. There has been some product innovation and differentiation. Consumers have good information about dimensions of competition such as prices, services, payment and pick-up locations, time to receipt and foreign exchange levels. In other markets, there are onerous regulatory hurdles, RSPs have difficulties securing bank accounts and it is costly to organize acquisition and distribution networks. Further, in these markets, many classes of institutions such as credit unions have been denied access to payment and settlement infrastructure, and consumers do not receive good information about prices and services.

7. There are different market outcomes at nearby but different geographic locations. For example, prices and services for remittances to the Dominican Republic differ among the various New York boroughs and counties. By contrast, studies by Condusef and Profeco (Mexican consumer protection authorities) show that price differences for sending money from various cities in the United States to Mexico narrowed significantly, but did not disappear, between 1999 and 2004.

8. About 60% to 70% of adult migrants of Latin American origin in the United States remit on a regular basis. Of these, more than 15% use informal methods—asking friends or family to carry money or mailing a money order. Five to 10% use depository institutions. The remaining about 70% use international money transfer companies that make electronic transfers. Globally, informal methods could account for up to one-third of the total. Cash is the primary payment medium.

9. The price of a remittance transaction is complex. The sending agent charges a fee (typically paid by the sender). There is a currency conversion fee for delivery of local currency to the beneficiary in another country. The MTO may charge the beneficiary a fee to collect the remittance. The remittance agents (especially banks) may earn interest in the period between receiving and delivering the funds. In addition to the direct price, many recipients travel long distances to collect their remittances.

10. The World Bank reports fees in the formal channels to be as high as 20 % of the principal, with an average of about 12%. Fees vary depending on the amount, channel, corridor, and transaction type. (See note on terminology below.) The fee as percentage of the principal falls off dramatically. E.g., major MTOs charge, for remittances from the United States to Mexico, more than 10% for \$100 but less than 3% for \$500. Informal channels are reported to be cheaper than formal channels and MTOs appear to be more expensive than banks and other financial institutions. Some high-volume corridors, such as United States–Mexico, are much cheaper than others. Urgent and faster transactions cost more than slow ones. Overall, fees are believed to have declined recently, although remain very high in low-volume corridors.

11. Remittance fees have declined in recent years in high-volume corridors in response to several factors. First, new entrants have intensified competition in mature corridors such as United States–Latin America. (There has been a decline of nearly 60% for United States–Mexico.) This takes the form of banks in sending countries using minimal remittance fees to attract migrants in order to cross-sell other banking services and banks in receiving countries competing for remittance customers. Second, technological change has reduced costs. The use of Internet-based technology for messaging and advanced clearing and settlement has reduced the cost of remittance transactions. And new remittance tools based on cell phones and smart cards have emerged. Third, government policies to establish bilateral initiatives (such as the Partnership for Progress between the United States and Mexico) have helped reduce remittance costs.

12. Currency conversion charges are even less transparent than remittance fees. They range from nothing, in dollarized economies, to 6% or more, depending on the country. Further, consumers may not be guaranteed an exchange rate when they initiate the transaction.

## 2. REGULATION

### A. Regulatory Barriers to Entry

13. Increased use of technology and globalization of capital markets has decreased the minimum efficient scale of many financial services. But major barriers to new RSP entrants are onerous regulatory barriers, difficulties securing bank accounts, and the cost of organizing acquisition and distribution networks. Examples include:

- Limits on the participation of certain kinds of institutions in remittances
- Different requirements across types of institutions
- Imposition of prudential requirements relative to systemic risk of remittance institutions
- The magnitude of licensing or registration fees
- Demands for identification not easily accessible by migrants.

14. *Questions for discussion:* Are there regulations that act as barriers to entry which could be made more pro-competitive while meeting public policy goals? How could they be made more pro-competitive? What incentives exist to use informal channels?

### B. Access to Financial Infrastructure

15. Most RSPs rely on the international financial infrastructure although the MTOs have their own, proprietary systems. Given the likely significant scale economies of such infrastructure, it is likely that small and medium-sized competitors must have access on fair and reasonable terms.

16. Competing networks may also require access to other financial infrastructure like foreign exchange services and national payment networks. However, regulators usually restrict access to national payments networks in order to protect the financial system. The result is that smaller financial institutions must enter a correspondence relationship with commercial banks.

17. There have been several examples of efforts to facilitate access to the financial infrastructure.

- The Automated Clearing House (ACH) connection between the Mexican and United States' payment systems, established by the U.S. Federal Reserve Bank and the Central Bank of Mexico, reduced the cost of bank transfers between the countries and ultimately led to new entry into the U.S.-Mexico corridor and to significantly decreased prices to consumers.
- The International Remittance Network (IRnet), established with the encouragement of the World Council of Credit Unions, lowered the cost of remittances between Latin America and the United States. IRnet was a response to regulations in some countries that denied credit unions access to the payments systems.

- In Brazil, a joint venture between Banco Bradesco and Correios, the national postal network, added 18,000 distribution points, approximately doubling distribution points and substantially expanding access outside of major urban areas.
- Mexico's national savings bank, Bansefi, constructed a domestic network open to Mexican credit unions meeting certain criteria. The network is intended to connect large sending networks and large receiving networks, enabling *inter alia* easy access to multiple MTOs to more remote receiving areas of Mexico.
- The Ecuadorian Central Bank is currently working to construct a secondary payments infrastructure for microfinance institutions and other financial entities in rural areas with limited access to payment systems in order to give them access to Central Bank payments infrastructure.

18. *Question for discussion:* What changes—modifications of regulations, establishment of new networks, and so on—could be made to significantly increase the access of rival remittance service providers to financial infrastructure to promote competition, while fulfilling the regulations' other public policy objectives?

### C. Informal Competitors

19. Regulation has important roles in ensuring that institutions offering financial services are sound and trustworthy. At the same time, if it raises the cost of providing formal remittance services, it provides incentives to substitute informal remittance services, a shift which is contrary to other public policy goals. Informal channels are said to be cheaper than formal ones.

20. *Question for discussion:* How does the presence of a significant proportion of informal RSPs affect the analysis, advocacy, and law enforcement by competition authorities?

## 3. INFORMATION ASYMMETRIES

21. At its simplest, if consumers do not know, or it is costly for them to learn about, the costs of remittance, they cannot compare competitors' offerings. This directly reduces competition.

22. The complexity of the pricing of a remittance transaction and the fact that some elements, such as the foreign exchange rate, are not known in advance, make price comparison difficult if not impossible.

23. Various institutions and groups—public authorities, international development agencies and civil society organizations (such as migrant support associations)—and the RSPs themselves have improved information about the industry. Public authorities have promoted consumer awareness of competitive alternatives. This has helped to increase competition dramatically in most remittance corridors. The government of Mexico has collected and disseminated institutional and pricing information to citizens both at home and abroad.

24. The quality of service provided by a RSP can be difficult to judge without experiencing a transaction. Hence, consumers are reluctant to switch providers.

25. *Questions for discussion:* Have efforts to make consumers more aware of competitive alternatives had an effect on competition? Does the provision of information by public authorities overcome consumers' reluctance to switch to a different RSP? What has been most effective? Do competition authorities have a role?

#### **4. EXCLUSIVITY AGREEMENTS AS BARRIERS TO ENTRY OR EXPANSION**

26. Exclusive access to an extensive distribution network may distort competition in the corridor. Where the exclusivity forecloses a substantial share of potential distribution agents and has an anticompetitive effect, such as increased prices, then the exclusive agreements would constitute a violation of competition law, at least in some jurisdictions. In such a situation, rivals could not expand effectively and entrants could not enter. The World Bank cites the ending of exclusivity agreements between the dominant MTO and distributors, and the entry of new competitors—especially banks—into the United States-Mexico corridor as key events leading to a steady decline in prices. As a general rule, effective competition requires that rival money transfer networks have access to distribution that is of reasonable quality and has a sufficient geographic coverage both in sending and receiving countries. Other provisions in the exclusive distribution contracts, such as lengthy "non-compete" clauses and long termination periods could enhance the anticompetitive effect of the exclusivity agreements.

27. The US Antitrust Division closed an investigation of Western Union's exclusive contracts with retail agents in early 2005, finding insufficient facts to support a claim but having "serious concerns regarding the lack of vigorous price competition in certain U.S.-foreign country 'corridors'." In 2003, the Russian Federal Antimonopoly Service found exclusive agreements between Western Union and retail agents to be abuses of dominance, a decision that has been upheld by the courts in 2004.

28. *Question for discussion:* Have any of the competition authorities found exclusive agreements between MTOs and privately owned networks, e.g., banks or retail chains, to be anticompetitive?

#### **5. COMPETITION ADVOCACY**

29. The background paper ends with a list of areas that are promising directions for additional activity within receiving countries:

- Improved estimation of informal transfers and their impact on competition in specific corridors;
- Detailed analysis of prices with increased attention related to sending and receiving locations and a range of money transfer and related products and services;

- Evaluation of foreign exchange spreads and their role in price competition;
- Quantification of market shares of major distributors of remittances;
- Spatial market analysis of urban/rural differentials in access and cost;
- Survey and assessment of receiving country distribution networks with particular attention to the role of exclusivity arrangements, barriers to widening distribution networks and obstacles to domestic institutions expanding abroad;
- Survey of services used, preferences, needs and shortcomings of existing services, as well as the potential for the entry of alternatives;
- Determination of information-related avenues for improving the competitive landscape;
- Assessment of payments systems and their impact on access, pricing and efficiency;
- Examination of existing and proposed regulations to determine whether any represent barriers to entry or measures that may drive formal remittances toward informality
- Regulatory assessment with the aim of ensuring non-discriminatory and proportionate prescriptions relative to risk posed by RSPs.

30. *Question for discussion:* What can competition authorities do in these areas?

#### ***A Note about Terminology***

The terminology in use in this policy area does not entirely correspond to terminology and concepts familiar to competition officials. “Corridor” is a country pair phenomenon, e.g., the “United States-Mexico corridor.” A corridor has multiple “channels” which differ according to the means by which the remittance is sent. E.g., “informal channels” refers to the use of unregulated money transfer firms or family and friends who carry remittances. One corridor could include several different antitrust geographic markets.