Why should financial institutions care about remittances?

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1. Remittances are large, counter-cyclical, and pro-poor. They are better targeted to the needs of the poor than official aid or foreign direct investment.
2. Financial institutions can make money while doing good for the poor, and for development of poor countries.
3. Remittances, and migration, are here to stay. Remittances are the largest single source of external financing in many developing countries. In 2006, recorded remittances exceeded $200 billion. Their true size is even larger. What you do for remittances will also apply to all retail payments, a much larger sum.
4. In the short-term, remittance costs are falling due to increased awareness, and greater competition. Yet, the market opportunity for financial institutions is increasing as the flows are shifting from informal to formal channels, and in the long-run, international migration, trade and investment flows are set to increase.
5. The remittance market is global in scope. Spanish banks are aware of the flows to Latin America than to other parts. Remittance flows from Spain to other parts appear significant. A new data set on bilateral migration and remittance flows indicates that Spain has substantial migration from Eastern Europe, Africa and Asia. Indeed, the size of the intra-Europe remittance market may also be under-appreciated. For example, it is not clear whether France receives more remittances from Spain than Morocco! In Eastern Europe, Romania, Ukraine, Poland, Lithuania appear large remittance destinations from Spain; in Africa, Senegal, Equatorial Guinea, and Nigeria; in Asia, China, the Philippines, India and Pakistan appear significant remittance destinations.
6. Besides providing remittance services for migrants, financial institutions can also provide remittance services for small-value transfers related to trade and investments.
7. Providing remittances will bring new customers for their deposit, loan and insurance products. At the same time, this process will encourage account-to-account transfers rather than cash-to-cash transfers. This process of financial deepening will encourage more saving by migrants and their beneficiaries. This process will also enable better matching of available saving with investment opportunities by professional financial institutions (rather than individuals who may or may not know how to invest).

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8. The technology for providing remittance services is changing. The traditional paper checks or money orders have given way to electronic transfers that worked through a combination of messaging and inter-bank clearing process. Recently we are seeing automatic clearing house systems, stored value cards, and cell-phone based remittances. These new instruments will mean more competition and smaller margins, but they also mean newer and bigger markets, and bigger profits. For example, many new instruments are being introduced in the mature North-North corridors or North-South remittance corridors. Yet, South-South remittance corridors are large, yet under-exploited; these corridors can only be exploited through new technologies that do not require huge and expensive infrastructure. Exploiting these new markets will also require unconventional partnerships, for example, with post offices in developing countries.

9. Financial institutions needing cheaper and longer-term capital can use future-flow of remittances as collateral. Financial institutions in many countries – Mexico, Brazil, Turkey, El Salvador, Kazakhstan, Egypt, Panama, and Ecuador – have raised over $10 billions during the last decade. Turkey raised over $5 billion last year through securitization of diversified payment rights (remittances, trade payments, investments). Even the remittances are not owned, only intermediated, by the concerned bank, the fact that the bank has stable access to foreign exchange from sources outside the national boundaries enables securitization structures to mitigate several key elements of sovereign risks (e.g., devaluation, expropriation and currency convertibility). The potential market for securitization is likely several times the size of the current market. Moreover, new research results suggest that many unrated poor countries are more creditworthy than previously believed. This finding suggests an even bigger market for future-flow securitization by sub-sovereign entities from unrated countries.

10. A hitherto unexploited market relating to the financial resources of the migrants is the market for so-called “diaspora bonds”. These bonds are actually financial instruments that can be sold by financial institutions to the members of the diaspora. Israel and India have between them raised nearly $40 billion in the past by issuing diaspora bonds. Israel issued these bonds to raise development financing while maintaining ties with its Diaspora. India issued diaspora bonds to raise external financing in times of funding crisis, e.g., after it faced sanctions from donors after the nuclear explosions in 1998. In both cases, these bonds were purchased by the diaspora members at a discount to the international borrowing costs prevailing at the time. Such discounts have no doubt a patriotic element. They may, however, be justified on rational grounds, as members of the diaspora are likely to have local currency needs for themselves or their relatives (which would imply less fear of currency devaluation); and they may also be able to influence the decision to repay loans (implying lower default risks). So far only public institutions of Israel and India have issued diaspora bonds. It should be possible, however, for private or sub-sovereign financial institutions to also issue diaspora bonds. For Spanish banks and financial institutions, this asset class can present

opportunities for investment banking (structuring, marketing of these deals on a fee-basis) and portfolio diversification. Also their subsidiaries in developing countries should be able to directly issue these bonds.

For migration and remittances data including bilateral flows, and the papers mentioned below, see the website of Development Prospects Group www.worldbank.org/prospects/migrationandremittances. The author can be reached at dratha@worldbank.org.

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