

# Remittances: De-risking and its Impact on Forum Island Countries

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# Remittances & FICs - Magnitude

Migrant remittance inflows (US\$ million)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015e	Remittances as a share of GDP in 2014 (%)
Fiji	204	205	183	147	171	174	160	191	204	206	222	4.5%
Kiribati	..	12	13	13	13	15	16	17	17	16	16	9.6%
Marshall Islands	24	26	25	23	24	22	22	23	25	26	27	14.0%
Micronesia, Fed. Sts.	..	..	..	..	17	18	19	21	22	23	24	7.3%
Palau	1	2	2	2	2	2	2	2	2	2	2	0.9%
Papua New Guinea	7	4	8	7	5	3	17	14	14	10	10	0.1%
Samoa	82	87	97	109	119	139	160	178	165	141	154	17.6%
Solomon Islands	7	11	13	9	13	14	17	21	21	16	17.642	1.4%
Tonga	69	79	101	94	72	77	79	118	121	118	118	27.1%
Tuvalu	5	4	6	6	5	4	5	4	4	4	4	10.7%
Vanuatu	5	5	6	9	11	12	22	22	24	28	28	3.5%



# Remittances & FICs - Importance

<b>Remittance as:</b>	<b>Economic Impact:</b>
Consumption;	<ul style="list-style-type: none"><li>→ Support GDP growth in the short-medium term;</li><li>→ Can have negative impact on external position if consumption drives imports (sudden surges inflows vs. time to build constraint)</li></ul>
Investment (in private sector & human capital);	<ul style="list-style-type: none"><li>→ Remittances are also used to support MSMEs (start-ups or bridging finance) and education/health care of family members;</li><li>→ Simultaneously, reduces government burden on social expenditure</li></ul>
Smoothing inter-temporal consumption;	<ul style="list-style-type: none"><li>→ Household receiving remittances on permanent basis tend to allocate and distribute consumption over time;</li><li>→ Enhances savings in the short-term</li></ul>
Global re-distribution of incomes across labour markets (FfD - AAAA - addressing inequality across borders);	<ul style="list-style-type: none"><li>→ Addresses global income inequality (to some extent) where workers in developed markets compensate the their families/friends in developing countries</li><li>→ Link to HIES → income disparity between the upper/lower quartile in recipient economy;</li><li>→ Migration of skilled labour increases short-term income prospects of the home country</li></ul>
Neutralising (to some extent) external shocks and supporting external positions (BoP)	<ul style="list-style-type: none"><li>→ Alleviates (to some extent) adverse external (world prices) /environmental (natural disaster) shocks</li><li>→ Support underlying BoP Position;</li><li>→ Remittance represents a relatively large part of Gross Foreign Exchange Reserves of Fiji, Samoa and Tonga</li></ul>



# Determinants of Remittances

- **Costs:**

1. **Agency Costs**

- Delivery of cheap & reliable service

2. **Exchange Rate Spreads**

- Asymmetric across borders - flexibility of margin larger in remitted economies, based on demand and supply of forex, costs of holding certain Pacific currencies and easy of transacting - i.e. Level of development of the financial infrastructure

- **Labour Market Conditions**

1. **Supply Side - Remitting Economies**

- Strengthen of Labour Market; Migration/Temporary Movement of NPs (Workers); No. of (Own) Dependents; Family links in Recipient Economies; Currency Volatility

2. **Demand Side - Recipient Economies**

- Family Needs/Obligations; Economic conditions; labour market; Catastrophic events

- **Financial System Development**

1. Range of **financial players and services**

2. Correlation between **forex spreads and fee charges** across banks and over time;

3. Variations in **forex spreads among banks**;

4. Correlation between **forex spreads and volumes of transactions** (remittances) across countries and banks;

5. Distribution of **transactions among banks** (is it concentrated) relative to the number of banks in the market;

6. What drives the **difference in MTO and bank forex spreads**; and

7. Comparison with **forex fees in other parts of the world** (e.g. Caribbean countries).



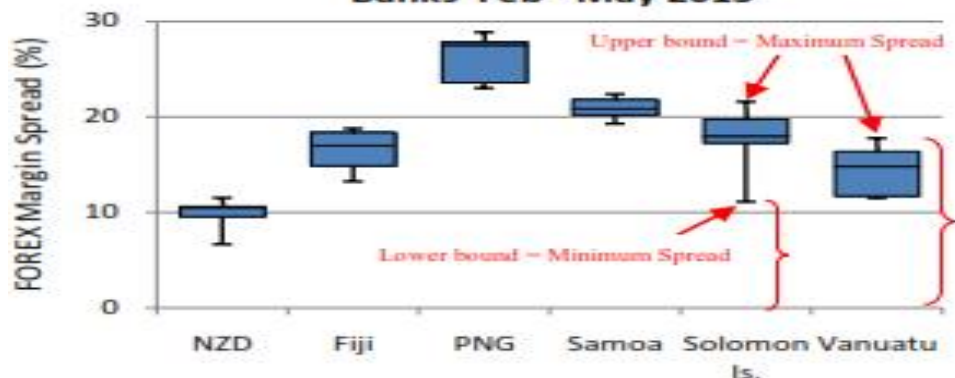
# Agency Costs

		Australia			USA			New Zealand		
		Fee	Total Cost	Total Cost	Fee	Total Cost	Total Cost	Fee	Total Cost	Total Cost
		(AUD)	(AUD)	(%)	(USD)	(USD)	(%)	(NZD)	(NZD)	(%)
Fiji	Bank Average	22.2	43.6	8.7	n/a	n/a	0.0	18.3	41.5	8.3
	MTO Average	10.8	23.8	4.8	20.2	34.5	6.9	11.2	24.3	4.9
	Overall Average	17.5	35.4	7.1	20.2	34.5	6.9	14.9	33.2	6.6
Samoa	Bank Average	24.4	80.9	16.2	n/a	n/a	0.0	19.6	52.9	10.6
	MTO Average	12.8	53.1	10.6	22.4	51.9	10.4	8.1	25.5	5.1
	Overall Average	18.2	66.1	13.2	22.4	51.9	10.4	12.9	36.8	7.4
Tonga	Bank Average	24.4	70.8	14.2	n/a	n/a	0.0	19.6	51.8	10.4
	MTO Average	13.0	43.2	8.6	17.4	44.7	8.9	7.8	33.5	6.7
	Overall Average	18.0	55.3	11.1	17.4	44.7	8.9	13.7	42.6	8.5
Tuvalu	Bank Average	25.8	25.8	5.2				23.6	32.5	6.5
	MTO Average	45.0	45.0	9.0				19.3	33.2	6.6
	Overall Average	28.8	28.8	5.8				22.6	32.7	6.5
Vanuatu	Bank Average	21.4	41.4	8.3				19.0	38.5	7.7
	MTO Average	28.2	44.1	8.8				22.0	28.1	5.6
	Overall Average	23.9	42.4	8.5				20.0	35.0	7.0

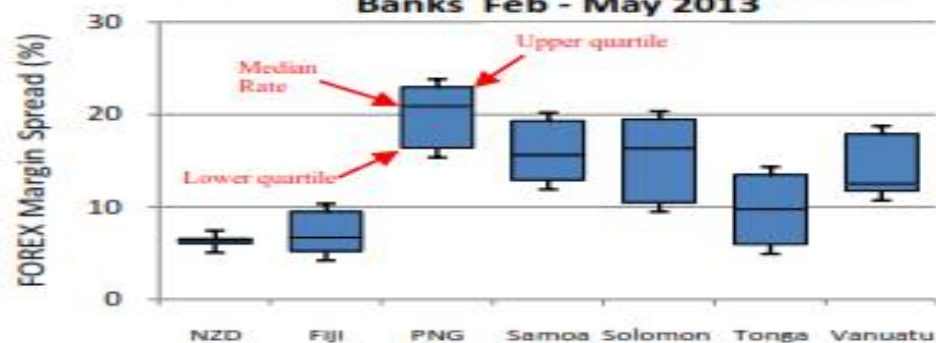


# Exchange Rate Spread

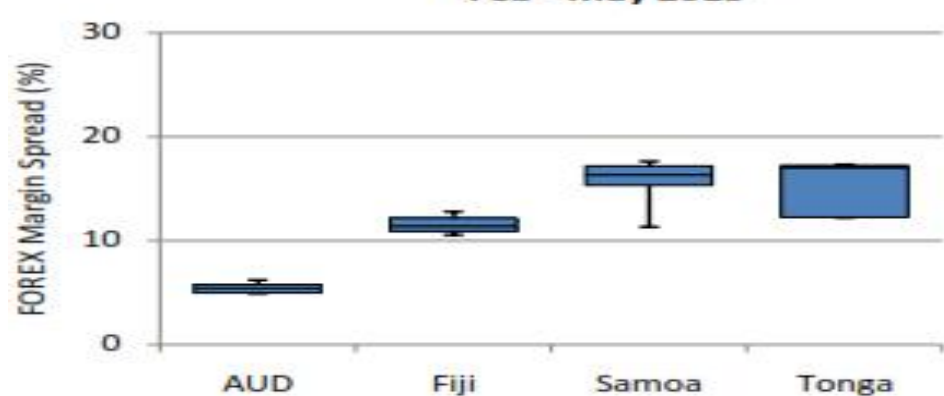
**Figure 9: FOREX Cash Spread Australian Banks Feb - May 2013**



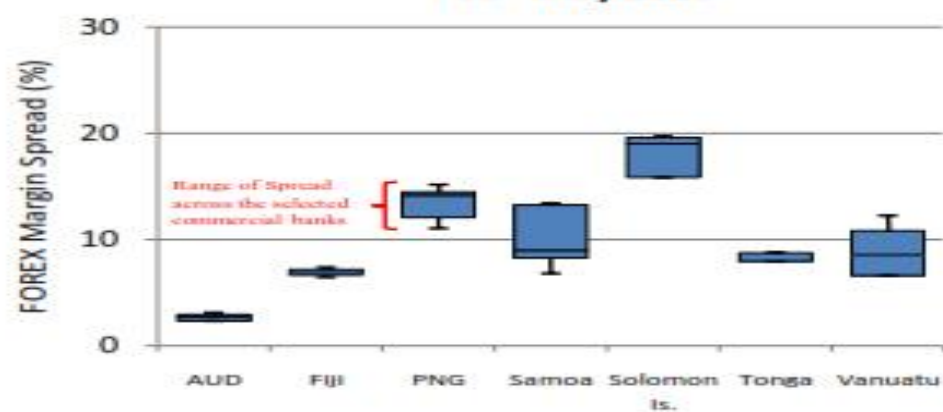
**Figure 10: FOREX TT Spread Australian Banks Feb - May 2013**



**Figure 11: FOREX Cash Spread NZ Banks Feb - May 2013**



**Figure 12: FOREX TT Spread NZ Banks Feb - May 2013**



# De-risking

## What is De-risking?

- “De-risking” refers to the global trend for commercial banks to close or restrict the accounts of customers including the accounts of remitters/ Remittance Network Providers (RNPs);

## Why De-risk?

- Closures and restrictions occur for a range of reasons, including:
  1. perceived reputational risk,
  2. money laundering risk,
  3. terrorism financing and associated sector sanctions risks;
  4. requirements imposed by international correspondent banks.





# De-risking

## De-risking vs. Managing Risks

- By De-risking:

1. Banks are avoiding risk in its entirety (wholesale approach)
2. Instead FATF (Financial Action Task Force) recommends managing risks AML/CTF selectively
3. **Investment in KYC** (Know Your Customers) → **KYCC** (Know Your Customers' Customer)

## Impact of De-risking on FICs?

- Concerns include:

1. Flow of funds between countries, notably from developed countries to developing countries and the implications for financial inclusion;
  - Difficulties in receiving remittances + Possibly high costs
  - Exclusion from the global financial system → implications for individuals and businesses to transact for trade of goods and services across borders
2. Loss of years of investment and commitment to development of reliable, low-value-low-cost financial infrastructure;
3. Limited number of foreign bank correspondent relationships;
4. Banks are ending correspondent relationships without evidence of wrongdoing and/or without giving clear reasons for their actions;
5. Countries currently affected: Samoa & Tonga (Closure of MTOs), RMI (Correspondent relationships)



# Policy Options

- **Global**

1. FATF – Look in to the options and impact the AML/CTF (About managing risks not avoiding it)
2. Diplomacy and Advocacy (SIDS → Developed Economies)
  - World Bank Study (request of the G20 and the Financial Stability Board (FSB)):
    - Ensure that the legal and regulatory AML/CFT framework is in place and supervised for compliance with those obligations
    - Respondent banks and MTOs seeking to should improve their AML/CFT internal controls to reduce their risk profile
    - Supervisors and other enforcement authorities need to be proactive and ensure effective risk-based supervision, as well as risk-based enforcement
3. Embracing Development in technology (Virtual & Crypto Currencies/Block Chain)
  - Commonwealth Bank of Australia and 10 of the world's largest banks have used a block-chain to simulate trading with each other using R3 (Jan 2016; Syd. Morning Herald)
  - R3 - private, peer-to-peer distributed ledger allowed the 11 banks to exchange value using "tokenised" assets without the need for a centralised third party



# Policy Options

## • Pacific

1. 2015 Forum Economic Ministers Decision
  - Advocacy at High Level Forums/G20/APEC 2018
2. Development of Financial Infrastructure (Payments System)
  - Different issues for:
    1. Dollarised FICs (8 FICs)
    2. Own Currency Arrangement (6 FICs)
3. Samoan Approach – Central Bank of Samoa
  - Gov't FOREX Bank Account → corresponding local disbursements by Government/CBS
4. Diaspora Bonds – Tonga exploring the idea
  - Could be used as a redeemable Financial Instrument (+ flexibility of ownership)
5. Commonwealth Finance Ministers Meeting 2015
  - Exploring Virtual Currency Option
6. FICs continue to invest in Regulatory and Supervisory roles on AML/CTF issues



# Policy Challenges

1. Global agenda on this slow to respond
2. Governments can't force Commercial Banks on de-risking
3. Technological advancement but are FICs ready to adopt
  - Low level of financial system development & lack of payments system in some countries
4. Investment requires partnership
  - May not be on the development agenda of Donors
  - Local capacity issues
  - Needs inclusion with proposed labour mobility schemes



Thank You!

