

INTERNATIONAL MONETARY FUND

**Approaches to a Regulatory Framework for**

**Formal and Informal Remittance Systems: Experiences and Lessons**

Prepared by the Monetary and Financial Systems Department<sup>1</sup>

In collaboration with the Legal Department and the World Bank  
and consultation with other departments

Approved by Stefan Ingves

February 17, 2005

Contents

Glossary.....	3
Overview and Executive Summary.....	4
I. Background, Ongoing Work, Terminology.....	6
A. Background.....	6
B. Ongoing Work in the Remittance Area.....	8
C. Terminology.....	9
II. Risks of Misuse to Remittance Systems.....	11
A. Vulnerabilities of Remittance Systems.....	11
B. Addressing ML/FT Risks: The FATF Requirements for Remittance Systems.....	11
III. Experience of Countries Adopting Regulatory Regimes for Remittance Systems.....	12
A. Countries with Registration Regimes.....	14
B. Countries with Licensing Regimes.....	15
C. Compliance with AML/CFT Requirements—Practices.....	17
D. Sanctions—Practices.....	19

---

<sup>1</sup> This paper was drafted by a staff team led by Chee Sung Lee and comprising Maud Bökkerink (both MFD), Joy Smallwood (LEG), and Raul Hernandez-Coss (The World Bank).

IV. Analysis of Regulations .....	19
A. Issues for Remitting Countries .....	19
B. Issues for Receiving Countries .....	20
V. Lessons from the Practices of Selected Countries.....	22
A. Lessons for Regulatory Frameworks.....	22
B. Lessons on Practices for AML/CFT Requirements.....	28
C. Lessons on Sanctions.....	29
VI. Issues for Discussion.....	29
Table	
1. Summary of Registration and Licensing Requirements.....	14
Boxes	
1. Loyalty Cards .....	18
2. Somali Financial Services Association .....	23
Appendices	
I. Improving Development Impact .....	31
II. Lowering Remittance Costs .....	32
III. Task Force to Develop Guidance on Payment System Aspects of International Remittance Systems .....	34
IV. Improving Data Collection.....	35
V. FATF Recommendations .....	37
VI. Requirements in Sample Countries for Regulating Money Remittance Providers.....	39

## GLOSSARY

AML	anti-money laundering
APEC	Asia-Pacific Economic Cooperation
CDD	customer due diligence
CFT	combating the financing of terrorism
FATF	Financial Action Task Force on money laundering
FIU	Financial Intelligence Unit
FSRB	FATF-style regional body
FT	financing of terrorism
G7	Group of Seven
G20	Group of Twenty
IFIs	international financial institutions
ML	money laundering
NGO	nongovernmental organization
SR	special recommendation
SRO	self-regulatory organization

## OVERVIEW AND EXECUTIVE SUMMARY

**Remittance flows are an important source of funds for many countries.** Money transfers to countries with a large number of overseas migrants have become the largest component of remittance flows. A large proportion of remittance flows goes through informal remittance systems. Following a review of informal remittance systems, the Executive Board requested more work to contribute toward implementing a suitable regulatory framework in line with FATF standards for such systems.

**Remittance systems face risks of misuse for money laundering (ML) or financing of terrorism (FT) similar to other financial sector activities.** Anonymous transactions, weak record keeping, non-transparent settlement systems, and the absence of regulatory oversight make remittance systems (especially informal ones) attractive vehicles for illicit activities.

**To address the ML/FT risks, the Financial Action Task Force on money laundering (FATF) issued a special recommendation that countries put in place a regulatory framework by licensing or registering money or value transfer providers and impose anti-money laundering and combating the financing of terrorism (AML/CFT) requirements on those providers.** FATF advocates flexibility in order not to impede the flow of remittances, and countries will have to implement this general guidance based on their specific circumstances.

**An important aspect of strengthening the integrity of remittance systems is to have a suitable regulatory framework to bring the informal remittance providers into the formal arena.** Informal remittance systems are widely used because of their speed, low cost, convenience, versatility, and potential for anonymity. Effective regulations should not impede the flows of remittances nor drive remittance systems underground. Implementation of remittance regulations is likely to take some time. In cash-based and low-income countries, implementation of an effective regulatory framework will be especially difficult because access to banking and other financial services is limited, and supervisory capacity is weak.

**Work on a regulatory framework for remittance systems is only part of the work on remittances.** There is extensive ongoing work by the World Bank, other IFIs, and national government agencies and academia on projects to promote the use of banking channels for remittances. Other work is addressing the macroeconomic impact of remittances and their links to the trade and foreign exchange areas.

**This paper reviews the experience of a sample of countries that have issued specific regulations to implement the FATF recommendations and presents some lessons for implementing a regulatory framework applicable to remittance systems.** By presenting and analyzing what is known about current practices in certain countries, this paper aims to provide preliminary operational guidance for countries that intend to adopt a regulatory framework for remittance systems. The work of the Fund on regulatory aspects of remittance

systems is part of the work program on AML/CFT assessments and technical assistance approved by the Board.

**Specifically, the following elements of a regulatory framework for remittance systems can be derived from the practices in the countries surveyed:**

- countries may choose between a registration or licensing regime depending on domestic circumstances;
- the registration or licensing requirements should be based on consultations with providers before regulations are enacted;
- the regulatory framework should include background checks on operators, on- and offsite monitoring, AML/CFT preventive programs and sanctions for noncompliance;
- the AML/CFT requirements consist of minimum customer identification, tailored record keeping and reporting of suspicious activity;
- an appropriate and proportionate regulatory system for remittances seems not to require elements of a prudential regime generally applied to banks and other traditional financial institutions. Some countries have included consumer protection elements in their framework.

**Finally, staff proposes that the findings be discussed further with the FATF and the FATF-style regional bodies (FSRBs) and national authorities and disseminated through publication of this paper.**

## I. BACKGROUND, ONGOING WORK, TERMINOLOGY

### A. Background

1. **Remittance flows are an important and stable source of funds for many countries and constitute a substantial part of financial inflows for countries with a large migrant labor force working abroad.**<sup>2</sup> Officially recorded remittances received by developing countries are estimated to have exceeded \$93 billion in 2003. They are now second only to foreign direct investment (around \$133 billion) as a source of external finance for developing countries. In 36 out of 153 developing countries, remittances were larger than all capital flows, public and private.<sup>3</sup>
2. **Remittance flows go through both formal and informal remittance systems.** Because of the importance of such flows to recipient countries, multilateral institutions and national authorities have made significant efforts in recent years to remove impediments and increase such flows. At the same time, however, there has been heightened concern about the potential for remittance systems, particularly those operating outside of the formal banking system, to be used as vehicles for money laundering (ML) and the financing of terrorism (FT).
3. **It is believed that the risk of misuse of remittance systems would be reduced if transfers were channeled through remittance systems that are subject to regulations and monitoring by national authorities.** To address the risks, a two-prong approach is evolving: 1) efforts by national authorities to encourage the use of formal systems (such as banks) by lowering the cost and increasing the access of users and recipients to the formal

---

<sup>2</sup> There is no universally accepted definition of remittances. Because this paper focuses on remittance systems in general, the coverage of remittances in this paper goes beyond the definition of transfers as defined in the Balance of Payments Manual, Fifth Edition, 1993, which includes workers' remittances, compensation of employees, and migrants' transfers. Remittances in this paper include both cross border and domestic transfers. They comprise unrequited transfers by workers abroad to their relatives, other household-to-household transfers, and transfers to/from non-governmental organizations. In addition, remittance systems may also be used by citizens and businesses to pay for services (e.g., education), investments and goods. Criminals may use remittance systems to launder money and to finance terrorism.

<sup>3</sup> Regionally, Latin America and the Caribbean received the largest share of estimated remittances, \$29.6 billion in 2003, or nearly a third of remittance flows to all developing countries. South Asia was the second largest recipient, with receipts amounting to \$18.2 billion. East Asia and the Pacific recorded \$17.6 billion, while Sub-Saharan Africa only accounted for \$4.1 billion, although this may reflect underreporting and lack of data. World Bank, 2004 Global Development Finance, Appendix A, Washington, DC.

financial sector; and 2) initiatives by national authorities to implement the recommendations of the Financial Action Task Force on money laundering (FATF) for remittance providers. The FATF recommends that each country should take measures to ensure that remittance providers should be either registered or licensed and subject to all FATF recommendations that apply to banks and non-bank financial institutions. Remittance providers who do not operate in accordance with regulatory requirements should be subject to administrative, civil or criminal sanctions.

4. **In 2003, the Fund’s Executive Board reviewed a joint Fund/Bank study of informal funds transfer systems,<sup>4</sup> and recommended that additional work be undertaken to better understand remittance systems** so as to help in the design and implementation of suitable regulatory frameworks. Executive Directors supported further work on:

- strengthening the information and data on remittance flows, particularly in countries where such flows are macro economically relevant;
- addressing weaknesses in the formal sector and raising its competitiveness to reduce incentives for the use of alternative systems;
- enhancing the regulatory framework to attract informal remittance providers into the formal sector, in line with FATF recommendations, with due regard for specific country circumstances and legal systems.

5. **This paper focuses on the regulatory framework for remittance systems consistent with FATF recommendations.** The objective of this paper is to share countries’ experiences with implementing a regulatory framework for registering or licensing remittance providers and propose preliminary operational guidance for assessors and technical assistance providers. The challenge facing countries is to devise a regulatory regime that addresses the risk of misuse of remittance systems while at the same time maintaining sufficient flexibility and efficiency (backed up by enforcement tools) to encourage entities currently in the informal sector to come under the regulatory regime. The findings of the paper are based on the experience of countries that have implemented *specific* regulatory regimes for remittance providers.

6. **The Board approved the Fund’s involvement in the assessment of compliance with the FATF standards (including for remittances).** This paper is part of an ongoing effort of Fund staff in coordination with FATF, World Bank and national authorities, to help

---

<sup>4</sup> “Informal Funds Transfer Systems. An Analysis of the Informal Hawala System,” Mohammed El Qorchi, Samuel Munzele Maimbo, and John F. Wilson, International Monetary Fund, 2003.

countries implement the FATF recommendations for remittance systems. The described experiences and lessons will serve as the basis for further discussions with FATF, national authorities, and participants in the remittance sector. The paper contributes to the Fund's assessment work and associated technical assistance in the remittance area, and may benefit countries that are embarking on implementation of a regulatory regime for the remittance sector. To date, not many countries have introduced specific regulations consistent with FATF recommendations to oversee remittance systems.

## **B. Ongoing Work in the Remittance Area**

7. **This paper complements other initiatives under way at the Fund and elsewhere on remittances.** Remittances have been a traditional focus of research by multilateral and regional development institutions and academia. Early work in this area focused on understanding the determinants and factors that shape the transfer of funds by migrants. It sought to explain the amount, frequency, volume, and duration of such transfers. There were also studies on how remittance funds were utilized and their impact on various income groups within recipient countries. Other research assessed the macroeconomic impact of remittance flows on countries and their links to the trade and foreign exchange areas. This work led to recognition of the need for improving information and statistics on remittance flows. With the current estimated size of remittance flows in some countries substantially larger than capital flows, the international financial community has begun to focus on how remittance systems function. In addition, many initiatives are under way to better understand and thereby facilitate the role of the remittance sector within the international financial architecture. Furthermore, important efforts are being focused on promoting the use of banking channels for remittances, by enhancing competition and reducing costs.

8. **Remittance initiatives may be categorized into four main groups:**

- The first group focuses on developmental aspects and issues. It involves international financial institutions (IFIs) and bilateral national agencies in partnership with academia and nongovernmental organizations (NGO). These studies aim to explore and foster links of remittance flows to poverty reduction programs and to stimulate financial development in rural areas and among low-income groups, e.g., through microfinance institutions and leveraging rural investment vehicles (see Appendix I).
- The second group of initiatives is more extensive and comprises efforts to lower transaction costs, increase transparency and improve the operations in the formal sector. This work is led by IFIs, national governments, and their bilateral agencies in partnership with NGOs, private financial institutions and remittance providers. Appendix II summarizes the various initiatives in this area.
- A third group of initiatives focuses on improving the infrastructure through which remittance transactions flow, with the aim of improving the functioning of the formal sector through the use and extension of existing payment system platforms. In



addition, the work also addresses issues of consumer protection for senders and recipients of remittances (see Appendix III).

- The fourth strand of on-going work seeks to improve the gathering of remittance data and involves IFIs, national statistical agencies, and others in academia to support and thereby strengthen the analysis of the economics behind remittances and its macroeconomic ramifications. The IMF's Statistics department is involved in consultative efforts with data users to better identify a common understanding of remittances and specific data needs. It is working with the World Bank and UN Statistic Department on a work program to enhance the definitions and concepts related to remittances in order to improve remittance measurements (see Appendix IV).

9. **In April 2004, the Fund and the United Arab Emirates (U.A.E.) jointly hosted an international conference on Hawala** (the traditional reference to remittance systems in the Middle East) to follow up on the Fund's remittance work. The meeting identified the challenges of implementing a regulatory framework for remittance systems without driving these operations underground. It was determined that close consultations with private sector remittance providers when developing regulations and operational guidance would help ensure the effectiveness of the new regulatory framework.

10. **As a follow up to the conference, staff has been working with national authorities and engaging the private remittance sector to gather information and identify good practices for a supervisory framework.** Discussions were held with selected country authorities in Europe, the U.A.E., and the United States, and the private remittance sector in these countries. These countries were selected because they have introduced specific regulations for remittance systems. Staff also visited a number of African countries to study the special problems facing cash-based economies in complying with supervisory and AML/CFT requirements for the remittance sector. Staff proposes to continue discussions in other regions of the world—specifically recipient countries—in order to obtain additional feedback for formulating a set of issues to consider when designing a regulatory framework and to use this paper as input into the work of standard setting bodies.

### C. Terminology

11. **Persons seeking to remit funds can use a variety of means.** They can utilize the transfer facilities of banks, dedicated money-transfer operators like Western Union or Moneygram, or non-bank financial institutions like credit unions, microfinance institutions, and exchange offices. There are also unconventional providers including individual business people, traders, ethnic stores, travel agencies, gas stations, and courier and bus companies. Regardless of whether it is a primary or secondary business or whether the providers are known to the authorities or not, they all provide the same service: they accept funds from the public on the basis that the funds will be paid out in another location.

12. **Who is a remittance provider?** Anyone (natural person or legal entity) that receives cash or cash equivalent [or any form of value], in a professional capacity or on a commercial basis, in order to make this cash or cash equivalent [or value] payable or causes it to be payable to a third party elsewhere, whether or not in the same form, is a remittance provider.

13. **It is difficult to distinguish between the “informal” and “formal” remittance systems.** Neither its cash basis nor the occasional character of its customer base provide a basis for saying that a transfer in which a person sends money through an unregistered travel agent (informal) is fundamentally different from a similar transaction conducted through a credit union (formal). Definition problems are compounded by the lack of consensus about terminology, ranging from “informal funds transfer systems,” “alternative remittance systems,” “underground banking,” “ethnic banking,” to “informal value transfer system.” (A more detailed description of the background, workings, and settlement methods of informal remittance systems is provided in El Qorchi et al (2003) and will not be further elaborated here).

14. **Informal providers may interact with the banking (formal) sector for some aspects of their activities.** For example, informal providers may utilize the payments mechanism of banks for settlements, but they also settle balances outside the banking system, for instance through other money transfer operators, trade transactions, and/or cash couriers. The findings of this study indicate that informal remittance providers use all available settlement mechanisms. Some use the banking system to settle with a counterpart in one country but trade transactions to settle with a partner in another country. This paper does not address how remittance settlement takes place. This area of the remittance system is an important topic for further work, and would be addressed by the World Bank/CPSS Task Force on remittances (see Appendix III).

15. **Although it is difficult to distinguish between the “formal” and “informal” sector, a clear distinction is whether or not a regulatory framework is applied to the remittance provider.** In this paper, “informal” is defined as a provider functioning without regulation or oversight of financial supervisors for its remittance services. Therefore, a “formal” provider is one regulated and overseen by competent government agencies for its remittance services. In this paper, it is important to keep in mind that remittance providers who are registered or licensed under a regulatory regime become part of the formal sector.

16. **In countries that have put in place a regime to regulate the remittance sector, providers that over time fail to be registered or licensed, would be illegal providers.** In countries that have not yet issued regulations for remittance providers (i.e., no registration or licensing requirements or a supervisory structure), it seems appropriate to refer to a regulated formal sector and an unregulated informal sector, where the informal sector would not necessarily be deemed illegal.

## II. RISKS OF MISUSE TO REMITTANCE SYSTEMS

### A. Vulnerabilities of Remittance Systems

17. **Any funds transfer system can be misused for money laundering or terrorist financing.** Like their counterparts in the traditional financial sector, operators of remittance systems could be misled by persons in terms of both the nature and intended purpose of the transaction as well as the identity of the persons sending and receiving the funds in question.

18. **Informal remittance providers that are completely unknown to the regulatory or supervisory bodies can be subject to misuse by criminals or terrorist.** The ML/FT risk increases with large cross-border settlements taking place outside the banking system for which regulators do not have full insight. In addition, informal remittance providers are often not aware of the risks associated with not undertaking customer due diligence, understanding the business of their clients, or recognizing illicit activity. While some customers may value anonymity, this is a key risk for ML/FT.

19. **Additional vulnerabilities identified include: circumventing any current and capital accounts controls,** evading excise or income tax requirements and smuggling (see El Qorchi et al, 2003, pages 12–13). Remittance providers have been associated with facilitating tax evasion and capital flight. Large remittance flows have also complicated the effectiveness of monetary policy and distorted the information on which macroeconomic policies are based.<sup>5</sup>

### B. Addressing ML/FT Risks: The FATF Requirements for Remittance Systems

20. **Responding to the ML/FT risks inherent in remittance systems, FATF issued Special Recommendation VI.** The FATF recommendations require countries to register or license remittance providers and be subject to effective systems for monitoring and ensuring compliance. FATF also requires that such providers be subject to AML/CFT measures,

---

<sup>5</sup> For example El Qorchi et al (2003, page 18) states that the indirect impact of remittance systems on monetary and exchange rate policy choices may be significant. The size of the informal financial sector can grow considerably if the distortions between the official and parallel exchange rates are significant. Also, large-scale remittances could exacerbate these distortions by diverting foreign currency away from the official banking system, thereby further widening the exchange spread. Such developments could influence the formulation and effectiveness of exchange rate policy. The flight of foreign currency outside the formal banking sector could also lead monetary authorities to change the course of monetary policy. They could, for instance, encourage banks to offer attractive interest rates on both domestic and foreign currency deposits with a view to reducing the amounts of domestic and foreign currencies kept outside the banking sector.

including customer identification, record keeping, suspicious transactions reporting and ML/FT prevention policies. Details of the FATF requirements are set out in Appendix V.

**21. Effective application of the FATF requirements is a challenge for most countries.**

As discussed above, remittance systems are useful and important for facilitating migrant flows. The FATF's Best Practices paper to Special Recommendation VI provides that government oversight should be flexible, effective, and proportional to the risk of misuse, but only provides general guidance on how to implement the requirements. An appropriate regulatory framework should not be so burdensome as to cause disruption to the flow of remittances or to cause remittance providers to go underground.<sup>6</sup> Specifically, staff discussions with the authorities indicate that:

- Supervisors need to have a better understanding of the nature of the remittance business to design a regulatory framework;
- Supervisors should show sufficient flexibility in dealing with remittance providers, but ensure that a regulatory system works effectively;
- Supervisors should have adequate resources and capacity to regulate remittance systems;
- Supervisors need to analyze the flow of remittance funds to detect irregularities and possible misuse of the system;
- Supervisors need to issue clear policies on how to deal with remittance providers that choose not to participate in the regulatory system.

**22. Further work is needed to address the lack of understanding and information on the types of settlement systems remitters use.** Traditionally, informal remitters have used a combination of formal and informal settlement systems (see El Qorchi et al, 2003, pages 14–17). Flexibility may entail tolerating the use of such settlement systems by a registered remitter if sufficient safeguards are in place to circumscribe misuse of the remittance system as a whole. In countries where formal financial systems are not well developed or absent altogether, like Afghanistan or Somalia, the authorities may have to recognize that remittance providers may continue to rely on all channels available to conduct their business.

### **III. EXPERIENCE OF COUNTRIES ADOPTING REGULATORY REGIMES FOR REMITTANCE SYSTEMS**

**23. Fund staff has analyzed a sample of countries that have adopted regulatory regimes consistent with the FATF recommendations for remittance providers.** Only a

---

<sup>6</sup> FATF Best Practices paper on alternative remittance systems, page 3.

few countries have issued *dedicated* regulations and have appointed a supervisor to register or license remittance providers and enforce the regulations.<sup>7</sup> Consistent with the flexibility built into the FATF's special recommendation, staff found that a variety of approaches for regulations have been taken by countries to bring remittance providers operating in the informal sector into the formal arena. The U.K., U.S. (on a federal level), and U.A.E. (for "hawaladars," a local term for remittance providers), have opted for a registration regime, while the Netherlands, Switzerland, Germany, the U.S. (on a state level), and the U.A.E. (for exchange houses) have a licensing regime. A summary of these countries' regulatory system is set forth in Appendix VI.

24. **There are two approaches to remitters that are not taken into consideration in this paper.** One approach used by some authorities is to require money remitters to obtain a banking license with the accompanying prudential conditions such as relatively high capital requirements. Other countries have simply prohibited the operations of money remitters, and require all remittances to flow through the banking sector. In cases where remittance services can only be offered by licensed banks (and therefore subject to prudential requirements such as capital adequacy, etc.) and where they are in compliance with FATF standards, the effects of these approaches on money remittance flows and their effectiveness in keeping remittance flows within the formal sector are unclear at this time and will require further research and discussions with the relevant authorities.

25. **The regulatory practices described in this section cover a sample of six countries.**<sup>8</sup> Sections III A and B describe the regulatory practices encountered while Sections III C and D describe the observed application of AML/CFT requirements and sanctions, respectively. Section IV analyzes these regimes and their effects on the remittance providers. Table 1 summarizes the main features of registration and licensing regimes.

---

<sup>7</sup> The FATF, for the purpose of Special Recommendation VI, explains *registration* to mean a requirement to register with or declare to a designated competent authority the existence of a money/value transfer service in order for the business to operate legally, and *licensing* to mean a requirement to obtain permission from a designated competent authority in order to operate a money/value transfer service legally.

<sup>8</sup> The sample covers only six countries because not many countries have issued specific regulations for remittance providers; many countries seem to apply their banking or credit institution law to remittance providers.

Table 1: Summary of Registration and Licensing Requirements

	<b>Registration</b>	<b>Licensing</b>
<b>Supervisory requirements:</b>		
Background checks	To identify providers, no consequences attached	Full fit-and-proper test
Internal procedures	Basic AML/CFT preventive measures	Detailed business plan, including AML/CFT preventive procedures
Monitoring	Basic reporting requirements and risk-based inspections	Basic reporting requirements and regular onsite inspections
Sanctions	Ranging from informal warnings to fines	Ranging from warnings to withdrawal of license
<b>AML/CFT requirements:</b>		
Customer identification	Required	Required
Record keeping	Required	Required
Suspicious transactions reporting	Required	Required

### A. Countries with Registration Regimes

26. **One group of countries analyzed has adopted a regulatory regime that requires all remittance providers to register.** Under a registration scheme, the key objective is to encourage remittance providers to identify themselves and to commit to comply with AML/CFT requirements. The main components of the regulatory framework in registration regimes generally include an application process, background checks, monitoring of compliance and AML/CFT preventive programs. Countries assign a variety of government agencies to supervise the providers, such as customs and tax authorities, financial intelligence unit (FIU), central bank or local authorities.

#### Application requirements

27. **One country has adopted a voluntary registration system for informal remittance providers** with the initial aim of identifying all such entities and on the expectation that this process will eventually ease them into the broader regulatory framework. To register, informal remittance providers have to fill in a simple registration form and provide a copy of their passport, a photo and, where applicable, a copy of the trade license for their other businesses. If satisfied following an interview with the applicant, the authorities issue a certificate as proof of registration, which is renewable every year.

28. **Other countries in the sample have adopted a mandatory registration system** that requires all remittance providers to register and provide the names and addresses of principals, agents and franchisees, information on the nature of the business, and the addresses of all premises. In one country, information on whether any manager or person in control has been convicted of money laundering must be provided. In this country, registration can be rejected when an applicant does not provide the required information or if it is discovered that the information furnished is false or misleading. One country's local authorities require remittance providers to put up a guarantee bond.

### **Background Checks**

29. **A simple background check is undertaken by most country authorities surveyed.** These checks are used mainly to identify operators in the risk-based approach for conducting supervision and generally do not affect the registration process.

### **Compliance monitoring**

30. **For onsite and offsite monitoring purposes, one country requires providers to submit information on all inward and outbound transactions every quarter.** This information includes the names of customers, place of work, nationality, passport number, transferred amount, beneficiary's name and country, and purpose of transfer. Another country only requires reporting of annual turnover.

31. **Some countries undertake periodic onsite inspections.** Registered providers are chosen for visits on the basis of risk analysis. In one country, the visits are only meant to get acquainted with the key persons in the operations and are not a proper onsite supervision as yet.

### **AML/CFT program**

32. **A challenge faced by all of the countries is to help remittance providers in setting up procedures to prevent ML/FT.** One country requires the provider to have a written anti-money laundering compliance program, including policies, procedures, and internal controls reasonably designed to assure compliance with the AML law; the designation of a compliance officer; education and/or training of appropriate personnel; and an independent (internal or external) review of the effectiveness of the AML/CFT program. The other surveyed countries do not require remittance providers to have specific AML/CFT programs.

### **Fees and Charges**

33. **One country imposes charges on registration and its annual renewal.** These charges are nominal (about \$100) and are used to cover the supervisor's cost for registration, training and supervision. Another country's local authorities charge fees ranging from about \$100 to several thousand dollars.

## **B. Countries with Licensing Regimes**

34. **In the countries visited that have chosen licensing regimes, only remittance providers that can demonstrate their ability ex-ante to comply with regulatory directives, including AML/CFT requirements, are permitted to operate legally.** The main components of the regulatory framework in licensing regimes generally include an application process, fit-and-proper tests, monitoring of compliance and business plans incorporating AML/CFT preventive programs. Countries have assigned a variety of agencies

to supervise the providers, such as a central bank, financial or money laundering supervisors, or self-regulatory organizations (SRO).

### **Application requirements**

35. **All countries surveyed have a licensing process that is less rigorous than that applied to banks and other prudentially regulated entities.** One country requires that providers are a commercial partnership or corporation but not a sole proprietorship, and that at least two trustworthy and qualified professionals manage the business. Another country requires the provider to be a commercial undertaking that is defined according to the level of annual gross income or annual volume of transactions. Generally, prudential requirements (such as capital requirements) are not applied. But in one country, remittance providers must have capital equivalent to \$0.5 million with an additional 10 percent of capital required for each branch. For the purpose of consumer protection, one country requires the remittance provider to put up a bank guarantee as a bond.

### **Fit-and-Proper Tests**

36. **All surveyed countries with a licensing regime perform fit-and-proper tests, including an examination for criminal records.** In general, countries require the applicant to have sufficient experience and knowledge of remittance systems. Countries do not grant licenses to applicants with criminal backgrounds or who pose risk to the integrity of the financial system.

### **Compliance monitoring**

37. **Some countries rely on onsite supervision for compliance checks, while others use external auditors.** One country requires compliance either by affiliation of the provider with a recognized SRO or directly with the relevant supervising authorities. Countries that conduct onsite inspections do so at least annually. External audits are mostly annual. Some countries require periodic reporting of information on flows by providers. However, most countries do not utilize this information to its fullest extent possible.

### **Business plan**

38. **All countries require the applicant to submit a business plan.** In general, this plan may include a description of the planned business, the organizational structure, and internal controls and AML/CFT compliance procedures. One country asks in addition for a bank reference and a letter of guarantee as a further indication of the applicant's legitimacy.

### **Supervisory fees and charges**

39. **Charges vary among countries and depend on whether the authorities want to cover the full costs of supervision themselves or partially recover such costs from the remittance providers.** Typically, there is a one time licensing fee from €1,000 to €3,000 (\$1,300 to \$3,900), and thereafter an annual fee in accordance with the size of the business.



One country does not charge any fees. Additionally, providers must pay for annual external audits.

### C. Compliance with AML/CFT Requirements—Practices

40. **In the countries reviewed, remittance providers are subject to two separate requirements:** the supervisory instructions (described above) and AML/CFT requirements with respect to their customers (described here). Remittance providers must identify their customers to deter criminals from misuse of the remittance system, which historically has had a tradition of anonymity. In this connection, for investigative purposes supervisors also emphasize the importance of a proper audit trail through requirements for appropriate record keeping. Finally, there are requirements for providers to report suspicious transactions to an FIU.

#### Identification

41. **Under FATF, as a minimum, remittance providers must verify the identity of customers for transactions above a threshold of €/\$15,000 or when conducting wire transfers.**<sup>9</sup> Many of the countries in this study have a policy that establishes a lower threshold for customer identification purposes. This policy varies from one that requires identification of every customer to one requiring identification when transaction amounts range between \$500 and \$3,000 (depending on the country). Only one country in the sample adopted the threshold of €15,000 although staff was informed that many remitters in this country already ask for identification when a transaction is as low as €750.

42. **The countries surveyed do not require remittance providers to apply full customer due diligence measures.** In many of the countries surveyed, the identification of customers was not considered to be a significant problem. The authorities stated that the predominant users of remittance services have some form of accepted identification, like a passport or a work/residence permit. This implies that undocumented persons would not be able to use registered/licensed remittance providers, which could impede access for this segment of users. In one country, in exceptional cases, identification requirements may be fulfilled by using a combination of other documents that can prove identity.

43. **The majority of remittance providers interviewed by staff stated that after they explained the purpose of the identification requirements to their customers, it did not constitute a real impediment for their business.** In addition, some remittance providers

---

<sup>9</sup> FATF recommendation 5 requires customer identification, including for occasional transactions. Special Recommendation VII covers the originator of wire transfers. In addition, FATF requires that on a risk-sensitive basis, providers may need to apply enhanced due diligence on customers.

have used this requirement as a marketing device to retain customers, e.g., through the use of so-called customer loyalty cards, which absolve the need for identification following the initial identification process (see Box 1).

#### Box 1. Loyalty Cards

Most remittance providers in one of the surveyed countries will issue regular customers a card following the fulfillment of the initial identification requirements. This card is part of a system that has embedded in it all the identity details of the customer, his address and designated beneficiaries. The benefits of this loyalty card to the customer include not having to go through the identification process for subsequent remittances and other financial transactions and a chance to win prizes ranging from free long distance telephone cards to cars. Frequent use of the card also attracts bonuses; for instance, the 5<sup>th</sup> remittance may be free of charge.

#### Record keeping

44. **The countries reviewed in this study generally apply the same retention period for keeping a record of transactions and identification data for remittance providers as that for the rest of the financial sector.** The period countries apply varies from five to ten years. While it is generally believed that most informal money remitters do not keep records, the study found that most remitters, even very small providers, keep basic records, some in simple ledgers others with sophisticated software. The problems that the supervisory authorities have encountered with such records are the variety of formats, insufficient information, illegibility, and even the use of different languages. Some authorities are dealing with these problems by providing standard formats for the recording of the required information, and, in some jurisdictions, software is provided for this purpose, thus also facilitating electronic transmission of such information where required. Remittance providers on their part pointed to the administrative burden which may add to costs and of the inconvenience of keeping records for a number of years, especially if these are in paper form.

#### Suspicious transaction reporting

45. **The standard requirement of AML/CFT regulation for suspicious transaction reporting is applicable to remittance providers.** This requirement is usually the same as that applied to other financial institutions. Two countries surveyed have an additional threshold reporting duty, which has resulted in numerous filings. While reporting on the basis of cash thresholds is clear, remittance providers reported difficulties in determining what constituted suspicious activity for the purposes of reporting. The authorities are trying to ameliorate this uncertainty through greater outreach and more information including typologies and indicators of money laundering risks.

## D. Sanctions—Practices

46. **Countries impose a variety of sanctions on remittance providers who do not register or secure a license to operate.** Legally established providers are also subject to sanctions if they do not comply with supervisory requirements, including those to deter ML/FT. For countries with a licensing regime the sanctions are similar to those imposed on other financial institutions ranging from warnings and fines to ultimately revoking the license. With some qualifications, authorities in countries with a registration system also have the power to impose similar penalties. For example, in one country, the authorities can impose a daily penalty on registered remitters (up to \$9,500) when they do not comply with the AML requirements, do not supply information, or do not pay the fees. But the same authorities have no power to prosecute unregistered remitters except to impose fines for not paying the fees as a proxy for not registering. In another country with a registration system, the authorities have no legal sanctioning powers if providers do not comply with regulatory requirements except a refusal to renew the registration.

## IV. ANALYSIS OF REGULATIONS

### A. Issues for Remitting Countries

47. **It is too early to determine the impact and effectiveness on the remittance systems of the different regulatory approaches adopted by the surveyed countries.** Many of these approaches have only been in place for a few years and are still in an early stage of implementation. Initial views from some countries have indicated that accessibility to remittance services has been enhanced and that formal (i.e., registered or licensed) remittance providers may afford some elements of consumer protection. Other countries expressed concern that a large number of informal remitters probably remain outside the regulatory regime. Also, the reporting and regulatory processes have started to provide the authorities with the necessary information to gain insight and knowledge of the remittance sector.

48. **All of the countries studied have regulatory frameworks that would appear to comply with FATF recommendations.** What is unknown at this time is whether the countries' implementation of their regimes, specifically the requirement for compliance monitoring, level of scrutiny applied to providers and resources available to supervisors, will be sufficient to comply with FATF recommendations.

49. **The practices of countries suggest that an appropriate and proportionate regulatory system for remittances would not require many elements of the prudential regime** generally applied to banks and other traditional financial institutions. The full range of supervisory tools found in banking legislation may be unnecessary for entities, which only perform money transfers. The authorities believe that their regulations serve to protect the integrity of the financial system and at the same time allow remittance providers to continue their business.

50. **There are advantages to both the registration and licensing regimes.** The advantage of a registration system is its simplicity for identifying money remittance

providers without imposing substantial upfront overhead costs on the authorities and the money remitters; especially when the prescreening process for entering the business is minimal. The licensing system, in contrast, generally includes as part of the approval process a due diligence on the integrity and capacity of the applicant to conduct a remittance business. This contributes to protecting the integrity of the financial system as a whole.

51. **Where registration systems have succeeded in identifying many of the remittance providers**, it has contributed to a better focus by the authorities in their efforts to increase operational transparency. The authorities are able to better target outreach and training for remitters to raise awareness on ML/FT risks and on measures to ameliorate such risks. The registration process and greater government involvement may, in turn, provide a degree of comfort to customers regarding the legitimacy of the registered providers. It is hoped that this will result in greater use of formal registered remitters.

52. **The background information on registered remittance providers, including any criminal record, provides supervisors with important inputs to focus inspections and assess risks in the remittance sector.** To date, it appears that in the countries surveyed many informal providers have not yet come forward for registration. The authorities have not yet determined the most effective mechanism for identifying and addressing informal remitters that do not register. In some jurisdictions, information provided by registered remitters has helped in identifying unregistered remitters, on the basis of which the authorities can pursue further outreach and enforcement actions.

53. **The licensing systems aim to reduce risks by restricting access to remitters** that do not fulfill fit-and-proper tests, and do not have proper internal procedures and organizational structures. However, it is likely that application requirements may have discouraged small providers from participating. The authorities in licensing regimes have reported the presence of many unlicensed providers, possibly indicating that providers have been driven underground. It remains uncertain if these unlicensed remitters are criminal elements or whether the licensing requirements are so burdensome and costly relative to the size of the business that smaller remittance providers have been reluctant to apply.

54. **All of the countries visited report that they are building their knowledge of the remittance business through closer interactions with providers.** Remitting countries are also beginning to explore how cross-border remittance transactions and protocols could be standardized. There are increasing government-to-government initiatives of remitting-receiving countries to focus attention on easing operations in clearly defined corridors of remittance flows (see Appendix II).

## **B. Issues for Receiving Countries**

55. **In the recipient countries surveyed, the authorities focused mainly on the regulation of systemically important financial entities.** A shortage of resources and skills prevent the authorities from addressing the regulation of informal remittance providers, although they have authorized the operations of conventional remitters like Western Union,

and postal offices. Furthermore, in terms of safeguarding the integrity of the financial sector, guidance relevant for cash-based economies in dealing with FATF standards on AML/CFT applicable to remittance providers remains to be developed. Ultimately, global efforts to reduce costs and stimulate a greater use of formal remitters are just as important at the recipient end of money transfers. Some recipient countries have worked with donors to put special programs in place for this purpose (see Appendices I and II) to leverage the large financial flows and to gather additional information.

**56. Initial results from the global efforts to reduce costs and accessibility impediments for remittances and to bring informal providers into the formal arena seemingly have begun to yield some results.** Some countries have reported large increases in recorded remittance flows, e.g., Bangladesh reported increases of 10 percent through November 2004, and in December 2004 the Philippines raised its target to 6 percent from the 3 percent target they set for 2004.

**57. In low-income developing economies cash remains the prevailing payment instrument.** In cash-based countries, a majority of the population does not have easy access to banking and other financial services for a variety of reasons. Informal remittance providers will likely continue to operate in areas where there are no other mechanisms available to transfer money. The beneficiaries of remittance transfers thus rely on a combination of formal and informal systems when receiving funds (see El Qorchi et al, 2003, pages 22–23). Formal remitters, other than banks, may include Western Union agents, bureaux de change, postal offices, and microfinance institutions. However, as beneficiaries are usually in remote areas or otherwise have no access to banks and other financial institutions, customers may still rely mainly on the informal remittance providers. In some recipient countries, there is evidence of emerging links between formal remittance providers and microfinance, credit unions, and rural finance cooperatives for the distribution of remittance proceeds to remote areas (see Appendix I). They not only include the transfer of funds, but are social networks that facilitate migration and adaptation of migrants to their new home. They also facilitate the transfer of “cultural” goods—such as food items.

**58. In the current environment and stage of financial system development in many recipient countries, funds arriving from a formal remittance provider in a sending country are likely to go through a formal remittance provider located in an urban area of the receiving country.** The receiving provider must then either rely on its internal network or microfinance/rural cooperatives to transmit the funds (mainly in cash) to the ultimate beneficiary in a different and at times distant location. This impediment would tend to add to costs and to slow the timeliness of transfers. For these countries, until the financial system deepens over time, it is likely that informal remittance providers like couriers, bus companies, and shop- or business owners will continue to play a major role, not only for international remittances, but also for domestic and inter-regional remittances. Further study remains to be done with respect to recipient countries when implementing the FATF recommendations on remittances.

## V. LESSONS FROM THE PRACTICES OF SELECTED COUNTRIES

59. **The international community recognizes that remittance flows are an important source of funds for many developing countries.** At the same time, remittance systems, particularly those involving informal remitters, pose risks of misuse for ML/FT. It is likely that initiatives to facilitate remittance flows described in Section I B through better information and enhancing the services in the formal banking sector will bear fruit over the medium- to long-term. There is, however, an urgent need to deal with the risk stemming from the operations of informal remittance providers by integrating them through a regulatory framework into the formal arena.

60. **For regulatory purposes, the FATF advises in its Special Recommendation VI that countries should license or register money or value transfer providers, and impose AML/CFT requirements on those providers.** Countries would need to decide on a registration or licensing regime on the basis of domestic circumstances and their legal and accepted tradition for regulatory practices. FATF has recognized that the need for government oversight should be flexible, effective, and proportional to the risk of misuse.

61. **FATF further advises that effective regulations should not impede the flows of remittances nor drive remittance systems underground.** Since countries will have to implement this recommendation in their own specific circumstances, this paper hopes to contribute to further discussions by sharing what is known about the experience of selected countries with implementing a regulatory framework applicable to remittance systems.<sup>10</sup> The experience of the countries surveyed indicates that the full implementation of remittance regulations consistent with FATF recommendations is likely to evolve and take some time.

### A. Lessons for Regulatory Frameworks

62. **The regulatory frameworks discussed below may be applied to remittance providers currently in the formal sector as well as those currently considered informal.** The framework is meant for providers who are not currently under any regulatory or prudential financial oversight that includes compliance with AML/CFT requirements. However, banks, other depository institutions, and other financial institutions, which conduct remittance operations but are already under the supervision of the relevant authorities, need not be subject to this remittance regulatory framework.

---

<sup>10</sup> Several of the issues addressed in this section are also to be found in the FATF's Best Practices paper on alternative remittance systems.

## Consultations before imposing a regulatory regime

**63. Discussions with authorities and private sector have shown that remitters should be consulted as the regulations and the associated requirements are developed.**

Remittance providers in general want to protect against flows from criminal proceeds and even support adoption of a formal regulatory environment to avoid being associated with criminals using remittance operators to conduct money laundering or terrorist financing activities. Consultations are also relevant when assessing if a registration or licensing regime should be adopted. It will allow the authorities to gauge if informal providers will be amenable to participating in the selected framework. If there are pre-existing associations of money remittance providers the authorities' task will be easier. If not, the authorities need to find different avenues for seeking the views of remitters to be regulated. Initially, this may involve the authorities promoting the forming of associations and supporting self-regulation to ease providers into the formal system (see Box 2).

### Box 2. Somali Financial Services Association

The offices of the UNDP and the EU for Somalia organized a series of workshops to explain the objectives of a regulatory framework and the avoidance of risks, together with measures that countries could take. As a result, the Somali Hawala companies set up an association, the Somali Financial Services Association (SFSA) that represented a first private initiative at self regulation. The association is working toward strengthening the functioning of the SFSA with training and capacity building technical assistance from UNDP and the EU.

## Registration or licensing

**64. Registration systems and licensing systems are alternative approaches to applying a regulatory framework to remittance providers, each consistent with FATF recommendations.** Registration systems raise few barriers to participation in the financial system but require an active follow-up to ensure compliance with the supervisory and AML/CFT requirements. Registration requires sufficient resources for ex-post monitoring by the supervisors using the information acquired during the application process. Licensing systems filter participation at the application stage to ensure that the remittance providers are suitable; this can reduce the level of compliance oversight afterwards. Because licensing puts more of the emphasis on the application phase, the initial requirements can result in fewer providers signing up.

**65. The choice of regime seems to reflect the characteristics of national financial systems as well as national approaches to financial regulation.** Registration systems have been adopted in countries with large numbers of informal remittance providers where the primary concern has been identifying remittance providers. Licensing systems have generally been adopted in countries with smaller informal remittance systems and where priority has been given to safeguarding the integrity of the financial system. In addition, the domestic circumstances that may affect a country's choice between a registration versus licensing

regime include resources available, supervisory capability, and vulnerability to ML/FT following a risk-based assessment.

### **Requirements for participation in the regulated system**

66. **Requirements should be clear and simple, regardless of whether a registration or a licensing regime is adopted.** This may include, depending on each country's circumstances and the choice of a registration or a licensing regime: an application process, the need for background checks, on- and offsite monitoring, and business and compliance programs.

#### *Application process*

67. **As most providers of remittance services are small businesses, it seems best to keep application procedures clear and simple.** Authorities should require information regarding the name(s) and the nature of the business, bank accounts used, addresses of all premises and branches, names and addresses of owner and agents, and whether any manager or person in control have certain criminal records. Countries that opt for a registration regime could benefit from this information for future inspections, whereas countries that choose a licensing regime will use this information in the approval process.

68. **Countries should require an annual renewal or review of the authorization granted** so that the regulators have at least yearly contact with, and updated information from the providers. Special attention needs to be focused on providers who are agents, franchise outlets, or subsidiaries of larger providers with extensive networks. The authorities should be in a position to determine the principal provider. Agents, franchisees, and subsidiaries associated with this principal provider need to be identified and need to be subject to the regulations.

#### *Background checks*

69. **An important objective of regulating remittance providers is to prevent remittance systems from being used by money launderers and financers of terrorism.** One of the basic requirements of a regulatory system is, therefore, that owners and managers of a remittance provider be identified and subject to at least a background check by the authorities. Elements of a background check should include examining for criminal records, such as financial crimes, money laundering, and financing of terrorism, as well as a basic competency assessment. In countries with a registration regime this information would be used for a risk-based approach for targeting inspections. A country that chooses a licensing regime may need to carry out thorough fit-and-proper tests to keep persons with criminal records from owning or managing a money transfer office. Applicants involved in financial crimes should not be granted authorization.



### *AML/CFT program and/or business plan*

70. **The FATF requires all remittance providers to have programs to guard against money laundering and terrorist financing.** The programs should include the development of internal policies, procedures and controls, appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees, an ongoing employee-training program, and an audit function to test the system. Depending on the size of the remittance provider, a dedicated compliance officer may be needed. Remittance providers in registration regimes should have this plan available to be reviewed during onsite inspections. In licensing regimes, and especially for a large remittance provider, a business plan may be an appropriate tool for the supervisor to assess if the applicant has the capacity to satisfy supervisory and AML/CFT requirements. While some countries may wish to include additional consumer protection or safety and soundness requirements in the business plan and in regulations, such requirements do not appear to be necessary for AML/CFT purposes.

### *Onsite inspections*

71. **One way of ensuring compliance with the regulatory requirements of registered/licensed remittance providers is to allow supervisors to perform onsite inspections.** In order to perform this function effectively, supervisors should have access to the premises of the money remitter and the authority to inspect and make copies of records, bank accounts, correspondence, and other information available on the premises to ensure compliance with supervisory directives, including AML/CFT requirements.

### *Offsite reporting*

72. **Remittance providers could be required to report and submit selected financial data and other information.** Before imposing this requirement, supervisors should consider the type of information needed to enable adequate offsite inspections and analysis of flows. This will help the country to improve information on financial flows and on the regulators understanding of the remittance business. This requirement should not be so excessive as to constitute an administrative burden. The regulators should facilitate the process by providing standard formats and, if feasible, software programs.

73. **When remittance providers are properly registered or licensed, one important, remaining vulnerability concerns the settlement of balances by providers.** This area is likely to remain opaque to supervisors and may involve risks for ML/FT. To gain insights into settlements, if this is not too onerous, providers could be asked to provide basic information on how outstanding in-bound and out-bound balances are settled.

### **Interaction with the banking system**

74. **Traditionally, some informal remittance providers (particularly smaller ones) have had problems with accessing banking services.** Some banks may decline such business because they are unwilling to take on the associated extra risks. The licensing of

remittance providers with regulators should provide sufficient assurance to banks that the provider is engaging in legitimate business. This may open up to licensed remitters the array of banking services needed to strengthen their activity and may contribute to lowering transaction costs. In addition, once the remittance sector is regulated, banks should be encouraged to operate with (small) remittance operators and any problems should be discussed with and hopefully addressed by the authorities.

75. **One particular area of concern discussed above, are the channels used by remittance providers in settling balances, in-country and cross border.** Access to banking services may make settlement more transparent to the extent that remittance providers settle balances by using their bank accounts and other banking services. This may assure some certainty of payment settlement for the remittance provider to the extent that bank transactions go through the traditional retail payment system and even high value gross real time settlement systems. In some countries, the authorities are exploring the possibility of giving larger registered remittance providers direct access to the retail payment system. Settlement using unconventional channels would thus be reduced. At the same time, regulators should also be provided with information on the proportion of settlement through the banking and formal payment system. This, together with information reported by registered/licensed providers, permits supervisors to have a better understanding of the settlement part of the business and thus helps to improve their response to the remaining vulnerabilities that may surface.

### **Consumer protection aspects**

76. **Country authorities may bring into play consumer protection aspects to attract customers to use remittance providers in the formal sector.** There are two main elements in the area of consumer protection: 1) to deter fraudulent operations or scams; 2) to ensure transparency of transaction fees and exchange rates. In general, an awareness and education campaign to inform consumers about their choices, rights, and the pitfalls when using the remittance system is important. In this regard, the advantages of using a registered/licensed remittance provider compared to an informal provider (i.e., not registered or licensed) should be clearly presented, including the need for the public to support the authorities' efforts to prevent misuse of the remittance system, including AML/CFT measures.

### **Capacity and cost considerations**

77. **Two considerations are important for a regulatory framework to be effective.** First, the supervisor must have the skills, capacity, and resources to conduct oversight and enforcement. Second, the regulatory regime should not impose too much of an administrative and cost burden on remittance provider. The balance of these considerations depends very much on a good understanding on the part of the authorities of the risks and vulnerabilities of the remittance system, which may impact the rest of the financial system, financial stability, and the possibility of misuse for ML/FT purposes. In addition, one of the other objectives is to facilitate the remittance flows, which may be important to the recipient country, and not

drive the business underground. A good measure of effectiveness is a high participation rate in registration/licensing and thereby conversion of informal providers into the formal arena.

78. **Supervisors should have sufficient resources to ensure compliance with regulation.** To support oversight of the regulatory framework, some countries charge steep application and annual fees and/or require expensive annual audits of compliance. While larger remittance providers may be able to internalize such cost, many smaller providers will have difficulties. Countries need to decide if the full costs of supervision should be recovered from fees and, within this, take into consideration the expenses of external audits required by the supervisors. For countries where high risks and vulnerabilities have been assessed, it may be necessary for the authorities to shoulder some of the costs, so that remittance providers are encouraged to register/license their operations. An education campaign may help convince both remittance providers and their customers of how the benefits of regulation outweigh its costs over time.

#### **Some considerations about the perspectives for remitting and receiving countries**

79. **In light of the different issues facing recipient countries, appropriate approaches to applying a regulatory framework in these countries will need further study.** Remitting countries have general concerns about the integrity of remittance systems and their impact on the rest of the financial system, particularly reputation risks stemming from ML/FT considerations. Recipient countries see regulations as a possible way to complement other policy measures they have in place, e.g., currency restrictions or current and capital account controls (see El Qorchi et al, 2003, pages 14–21). Recent initiatives by the G7, G20, and APEC finance ministers have the objective of closing the gap in the reporting of information on flows between recipient and remitting countries (see Appendix II). Such efforts seek to improve flows and information through distinct corridors where migrant groups are concentrated. These efforts address remittances from developed to developing countries as well as for remittances between developing countries.

80. **For the purpose of cross-border cooperation and information-sharing arrangements, much work remains to be done.** Some countries consider the list of registered/licensed remittance providers and associated information to be confidential. As a result, other countries with stricter regulations cannot use the information to prosecute illegal providers operating in their countries. A decision not to publish the list of remittance providers may also defeat the purpose of the registration as a signal to consumers about the providers' legality. In such instances, the individual display of an official certificate or license on the premise might still serve the purpose of conveying legitimacy and transparency.

## B. Lessons on Practices for AML/CFT Requirements<sup>11</sup>

### Identification

81. **Appropriate documentation to identify customers is a strict regulatory requirement for all activities in the financial sector, including for users of remittance services.** This requirement poses an especially difficult problem for customers of remittance providers because many of them are migrant workers, including undocumented or illegal workers. Countries have used several ways to address the need for appropriate identification. One practice is to set the cash threshold above which identification is needed at a level higher than average remittance amounts. This requires knowledge of the remittance market on the part of regulators. However, in case of suspicions of money laundering or terrorist financing, the full identification of the customer in question is needed regardless of the transaction amount.

82. **Some countries have allowed identification cards issued by national consulates to qualify as appropriate documentation.** Other countries have allowed the use of a combination of documents to satisfy the identity requirement. In some recipient countries, respected community leaders could vouch for the identity of the customer. On receipt of funds, the identity of the beneficiary should also be taken and recorded. In any case, providers in the recipient countries have a special interest in the identity of the beneficiary to ensure that funds are being paid out to the correct person.

83. **Based on the practice in the visited countries, application of full customer due diligence would not seem necessary.** Even if transactions with a customer occur regularly (i.e., several times per year), they are still considered to be occasional transactions. There is, in general, not an ongoing business relationship with customers comparable to account holders at banks. However, on a risk-sensitive basis, providers may still need to apply enhanced due diligence depending on the type of customer or nature of the transaction.

### Record keeping

84. **As discussed above, record keeping by remittance providers is essential and some countries have devised simple formats or provided software.** Guidelines should be drawn up to ensure that transactions are transparent and traceable to assist in investigations when misuse of the system is detected. Remittance providers are required to keep records on transactions and copies of the identification data, account files and business correspondence (if any). Such records should be made available when needed by the authorities, and good practice would dictate that records be held for five years.

---

<sup>11</sup> FATF's AML/CFT requirements should be applied to all remittance businesses, regardless of whether a country has chosen a registration or a licensing regime.

## Reporting of suspicious transactions

85. **Most remittance providers maintain a stable relationship with frequent customers.** They are, thus, better able to determine if a transaction is extraordinary or suspicious. Determining a suspicious transaction with regards to an occasional customer is more difficult. Awareness raising, education, training, frequent on-going consultation, including onsite visits would be needed on a continuous basis on the part of the authorities to improve the quality and number of reports. Some countries have relied heavily on threshold reporting requirements, although these may pose an administrative burden for both providers and the financial intelligence unit. In addition, it is not clear if useful information could be obtained from such reporting, even when there is capacity to screen the reports.

### C. Lessons on Sanctions

86. **There are two types of sanctions that authorities should be able to impose:**  
1) sanctions on remittance providers who have not registered or obtained a license;  
2) sanctions for registered or licensed providers if they do not comply with supervisory or AML/CFT requirements. In general, the sanctions should be similar to those imposed on other financial institutions. Furthermore, it is important that the authorities have power to take actions against remitters that choose not to register or apply for a license. To prevent misuse of remittance systems, and to encourage compliance with regulatory standards, supervisors should make known that they are actively enforcing the regulations.

## VI. ISSUES FOR DISCUSSION

87. Executive Directors may wish to discuss the following issues:

- **Regulatory framework for remittance systems:** How do Executive Directors view the scope and main elements of the lessons laid out in Section V above?
- **Coordination with the FATF/FSRBs, national authorities and other IFIs:** Do Executive Directors consider the findings of the paper to be a useful basis for further discussions with standard setters, national authorities, and other IFIs in continuing efforts to contribute toward developing operational guidelines for AML/CFT assessments and technical assistance work?
- **Ongoing work on regulatory issues:** Considering all the challenges in the financial system, including AML/CFT, do Executive Directors support further work by Fund staff toward identifying practices and operational issues on the regulation of remittance systems in line with the FATF recommendations? Do Directors support further work by staff on examining the impact of the proposed regulatory framework on developing countries?
- **Other work on remittance systems:** Do Directors support further staff work to better understand the whole range of remittance settlement systems by which

providers settle balances outside of the formal sector? Do Directors want staff to address other macro economically relevant issues with links to remittance systems?

- **Next steps:** As on the previous occasion, following the Executive Board discussions, it is envisaged that the findings of this paper will be presented at the Third Hawala conference in U.A.E. in early-April 2005. The staff recommends the publication of this paper following the informal Executive Board seminar.

## **Improving Development Impact**

Work has been conducted to analyze the impact of remittance flows for poverty reduction, financial development in rural areas and among low-income groups, e.g., through microfinance institutions and leveraging rural investment vehicles. There are projects that examine how remittances could reduce income inequality, their role as investment in human or physical capital, and at the macro-level, how remittances impact a country's access to capital markets.

### **World Bank**

Several studies and household surveys in selected countries to study the effect of remittances on poverty and education, and to provide specific policy guidance on short / long term policies to maximize the developmental potential of worker remittances.

### **Inter-Agency Remittances Task Force**

Following a 2003 International Conference on Migrant Remittances, an inter-agency task force comprising the World Bank, the U.K.'s Department for International Development, the Inter-American Development Bank, IMF, U.S. Treasury, the European Commission, Canada, the German Gesellschaft für Technische Zusammenarbeit, and the International Labor Office was formed. The task force focuses on collaboration in developing core principles in public policy and private enterprise to support remittance, improving data and information about remittances, coordinating remittance programs, and exploring the broader development impact of remittances (link to: [International Conference on Migrant Remittances](#)).

### **International Labor Office (ILO)**

The ILO is conducting a study of the role and potential of formal financial institutions in the transfer of remittance in the EU's "new neighbors." In particular to analyze the potential of linkages between social partners (employers-, workers organizations and migrants associations) and formal financial institutions in order to improve the transfer of remittances and thereby leveraging its development impact (link to: [ILO Social Finance Program](#)).

### **Consultative Group to Assist the Poor (CGAP)**

**CGAP** is conducting a study of domestic and international money transfer demand among and channels available to labor migrants in China and India; a study of money transfer options available to labor migrants in South Africa, with emphasis on regional money transfers and barriers to private sector service provision in this market segment (link to: [CGAP](#)).

### **International Office for Migration (IOM)**

IOM is conducting various studies in Italy, the Balkans, and Africa to identify replicable remittances management best practices; to elaborate policy guidelines with operational suggestions for African countries and relevant institutions wishing to harness the development potential of migrants' resources; to strengthen the institutional and technical capabilities of government and non-government agencies to understand the impact of migrant remittances (link to: [IOM Migration and Development](#)).

## **Lowering Remittance Costs**

High remittance costs, often in the range of 10–20 percent of the principal amount being remitted, are a major drain on remittance flows to developing countries. High costs also encourage remittance senders to use informal channels, which often appear to be less expensive. Average remittance costs are typically higher for small amounts of transfers. Major initiatives include work on harmonizing payment systems so that operators do not have to invest in expensive proprietary systems of their own, and improving competition among remittance service providers.

### **World Bank**

Global study of central banks to understand how central banks collect data on remittances, size of flows, channels, sources and destinations, and regulatory regime and of remittance agents worldwide to understand their business models, geographical coverage, size of flows, regulatory environment and costs.

### **Inter-American Development Bank (IDB)**

The IDB's Multilateral Investment Fund has pioneered remittance research through extensive fieldwork in Latin America and the Caribbean and widespread public outreach to forge more efficient public-private partnerships to support the efficient delivery of remittance services (link to: [IDB - Multilateral Investment Fund](#)).

### **Asian Development Bank (ADB)**

The ADB completed its first country case study on the Philippines remittance industry, and is extending the study to review overseas' remittance flows among Indonesia, Japan, Malaysia, Singapore, Hong Kong, China and Philippines, and identify factors in the policy, regulatory, and institutional framework that impact these flows. The study examines (i) estimated movement of remittances both through formal and informal channels; (ii) "first-mile" and "last-mile" issues in the jurisdiction concerned; and (iii) the analysis of existing remittance channels including the factors affecting peoples' choice of the remittance methods and the regulatory aspects of remittances (link to: [ADB Workers' remittances](#)).

### **Asia-Pacific Economic Cooperation (APEC)**

The 2003 APEC Report on Alternative Remittance Systems examined the economic, regulatory and institutional factors that promote the use of informal financial systems over formal financial systems. An analytical framework was designed to examine these incentives and applied in several country case studies: the U.S.-Mexico and Canada-Vietnam corridors for remittance (link to: [APEC Initiative on Remittance Systems](#)).

### **United States**

U.S. Agency for International Development is working with recipient remittances countries on improving access to financial services, supporting hometown associations, and engaging in research and dissemination of information (link to: [USAID microfinance and remittances](#)).

U.S. Treasury, Office of International Affairs, developed a remittance initiative in 2001 to examine how to increase transparency of the costs of remittance services; expand financial



literacy in the United States for Mexican immigrants; raising general awareness of the importance of the U.S.-Mexico remittance market which prompted more private sector competition (link to: [U.S. Treasury, Office of International Affairs](#)).

### **Department for International Development (DFID)**

DFID is developing remittance partnerships (Nigeria, Bangladesh, and Ghana) to include a range of measures to remove impediments to remittance flows, to improve access for poor and rural people to remittances and other financial services, to strengthen the capacity of the financial sector to provide efficient and widespread transfer payment services. DFID is also co-funding a survey of remittance products available to migrants in the U.K., which will encompass costs, transparency, and access (link to: [DFID](#)).

### **ILO**

Several case studies to map current remittance patterns between and within countries and to assess the availability of suitable transfer services and the transaction costs involved in Senegal, South Africa, Bangladesh, Nepal, and Mexico (link to: [ILO publications](#)).

### **IOM**

Case study of Vietnam to compile information on remittances options to Vietnam (primarily from Canada and the United States) to serve as basis for the development of a curriculum for “Orientation on Remittances” to IOM assisted migrants. Options for financial support from local remittances actors will be investigated to ensure sustainability of the course, as well as scope for increasing the course outreach to include non-IOM assisted migrants.

### **Private sector initiatives**

The World Council of Credit Unions (WOCCU) has developed a cross-border payment system, called *IRnet*, that would allow migrants to make remittances at lower costs (link to: [WOCCU IRnet](#)); WOCCU has also partnered with MoneyGram to globally add credit unions as senders. Partnerships of financial institutions like La Caixa in Spain (link to: [La Caixa Transfer Services](#)), or large banks in the U.S. (including Citibank, Bank of America, Wells Fargo) with banks in Latin America are very valuable initiatives that support the shift of remittances to the formal sector. Other initiatives have been implemented in Singapore, Malaysia and the Philippines, aimed at streamlining the remittances process. Initiatives of card-companies, like VISA, offer new options for remittances (link to: [VISA Remittances](#)).

### **Task Force to Develop Guidance on Payment System Aspects of International Remittance Systems**

The World Bank and the Committee for Payment and Settlement Systems (CPSS) at the Bank for International Settlements convened a Task Force end of 2004 to develop guidance on payment system aspects of remittances that be considered best practices and principles following discussions with stakeholders. The guidelines will assist central banks, financial authorities and market participants in the development of remittance-related infrastructure and policies and complement work in the regulatory area. The Task Force is made up of representatives from central banks from major remittance sending countries, as well from central banks in receiving countries, regional development banks, the IMF and the Arab Monetary Fund.

The Task Force is to develop principles on remittances describing key features and functions that should be satisfied by remittance systems, providers, and financial intermediaries. Aspects that are of importance are an appropriate level of consumer protection, promotion of efficiency, and enhancement of cost effectiveness. The two latter objectives could be achieved by (i) enlargement of competition; (ii) ensuring transparency of fees charged, exchange rates applied etc., and (iii) standardization of protocols and messaging formats. The underlying goal will be to enhance efficiency and competition in order to lower the costs for the users and to promote a shift from the unofficial to the official infrastructure.

The Task Force consists of four working groups.

- The first working group maps out and compares the remittance market in different countries by means of a questionnaire to survey the role of central banks and the functioning of the remittance markets.
- The second group concentrates on appropriate levels of consumer protection and the enlargement of transparency of fees and services. Providers should charge fair prices and the sender should know as far as possible the amount to be paid out to the beneficiary. The group also analyzes cost structures and different pricing methodologies.
- The third group focuses on access and competition issues and deals with operational reliability and possible new technological developments. Relevant is the access of the beneficiary to banking services, which might be a problem in rural areas of developing countries.
- The fourth group deals with oversight of central banks of the remittance market and the different roles of central banks in this area. Payment system oversight focuses on efficiency, reliability and risk reduction. It will not deal with anti-money laundering and combating terrorist financing which is the province of banking supervisors or specialized authorities.

The output of the Task Force will be a report finalized within 2005 that will outline a set of relevant principles or best practices.

## **Improving Data Collection**

### **IMF Committee on Balance of Payments Statistics**

It has initiated work on strengthening international guidelines for the reporting of remittances, in the context of the much wider revision of the fifth edition of the IMF's Balance of Payments Manual (BPM5) and the corresponding review of the System of National Accounts 1993 (1993 SNA). The full revised manual is due by end-2008 (link to: [IMF Committee on Balance of Payments Statistics](#)).

The Statistics Department of the IMF and the Development Data Group of the World Bank have, in response to a request for improvements in remittance data by the G7 Finance Ministers meeting at Sea Island in June 2004, organized a meeting of users and producers of remittance data in January 2005 to discuss the measurement of remittances. The meeting agreed that the Balance of Payments represents the appropriate framework for improving the estimation and reporting of remittance data. The Technical Subgroup on the Movement of Natural Persons (TSG), chaired by the UN Statistics Division, has begun to discuss the measurement of remittances, and is reporting to the Inter-agency Task Force on Statistics of International Trade in Services and the IMF Committee on Balance of Payments Statistics on this issue. The subgroup will consider adjustments to its terms of reference in order to make recommendations on improvements in remittance measurement independently of migration issues. The TSG plans to present the framework to the IMF Committee in June 2005 and subsequently to other groups engaged in the review of the 1993 SNA (link to: [UN TSG](#)).

A core group of participants, including the World Bank, IMF, and UN Statistics Division, will develop a more detailed work plan, monitor progress, and prepare a report by September 2005 for the G7 Finance Ministers.

### **World Bank**

The World Bank Development Data Group is working with the IMF on the request by the G7 for improving international collection of remittance data (link to: [Bank/Fund meeting on remittances data](#)).

The World Bank's Global Development Finance is an annual review of recent trends in and prospects for financial flows to developing countries; chapter 7 of the 2003 review "Workers' Remittances: An Important and Stable Source of External Development Finance" provides an estimate of remittance flows (link to: [2003 Global Development Finance](#)).

### **OECD**

The OECD prepared for the Roundtable on Sustainable Development a document that presents a worldwide matrix of international remittance flows based on IMF and other data (link to: [OECD Roundtable on Sustainable Development](#)).

### **United Kingdom**

The U.K.'s Office of National Statistics (ONS) is working to improve the estimates of workers' remittances in the U.K. DFID prepared a report on remittances with U.K. Treasury

and ONS, and commissioned a report on informal remittances from the U.K. (latter available on [UK Livelihoods](#)).

### **ILO**

The ILO decided during its 92<sup>nd</sup> Annual Conference that it will carry out a plan of action, in partnership with other relevant international organizations, that includes the improvement of the information and knowledge base on global trends in labor migration, conditions of migrant workers, and effective measures to protect their rights (link to: [Press release 92nd Annual Conference](#)).

### **IOM**

IOM Statistical Information System on Migration in Central America is designed to provide adequate, timely and compatible migration data from various sources through an Information System on Migration for the Central American region.

### **European Commission**

In order to enhance the knowledge base about the workers' remittances from the European Union, the European Commission conducted in March/April 2004 an ad-hoc survey of member states. Most member states provided overall amounts and estimated the share of remittances sent to developing countries. They stressed factors likely to result in an underestimation of remittances. The overall figure of some €17 billion flowing from 11 member states in 2003 should therefore be interpreted as a lower boundary estimate.

In addition, there is a proposal for a Directive of the European Parliament and of the Council on Payment Services that aims at establishing a level playing field for the activity of payment institutions (which includes money remittance) in the EU. The planned regulatory regime for money remitters will require a special license adapted to the specific risk profile of this activity.

### FATF Recommendations

After the events of September 11, 2001 in the United States, the FATF issued eight<sup>12</sup> special recommendations (SR) to combat the financing of terrorism. The FATF has drafted SR VI specifically to regulate (alternative) remittance systems:

*“Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.”*

SR VI and the related Interpretative Note to SR VI essentially have three core elements:

- jurisdictions should require licensing or registration of persons (natural or legal) that provide money or value transfer services, including through informal systems;
- jurisdictions should ensure that money or value transmission services, including informal systems, are subject to applicable FATF Forty Recommendations (2003) (in particular, recommendations 4–16 and 21–25) and the Nine Special Recommendations (in particular SR VII); and
- jurisdictions should be able to impose sanctions on money or value transfer services, including informal systems, that operate without a license or registration and that fail to comply with relevant FATF recommendations.

In addition to the SR VI, with the revision of the FATF forty recommendations in 2003, the FATF has decided that everybody that conducts the money or value transfer activities is a financial institution, and thus, that all FATF recommendations apply to remittance businesses.

As mentioned above, the most relevant recommendations are recommendations 4 to 16 that concern customer due diligence and record keeping and the reporting of suspicious transactions, internal policies and compliance, and recommendations 21 to 25 that concern regulatory and supervisory aspects.

Most relevant identification requirement under recommendation 5 for remittance providers is the requirement to identify a customer carrying out an occasional transaction above the designated threshold of €/\$15,000 or that are wire transfers (SR VII). Additional circumstances for identification are when there is a suspicion of money laundering or terrorist financing; or when the remittance provider has doubts about the veracity or adequacy of previously obtained customer identification data.

---

<sup>12</sup> In October 2004, the FATF has added a ninth special recommendation on cash couriers.

Recommendation 5 also requires further customer due diligence (CDD) measures as follows: (i) identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information; (ii) identifying the beneficial owner; (iii) obtaining information on the purpose and intended nature of the business relationship; (iv) conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship. With the exception of the first measure, the other CDD measures apply in general to ongoing business relationships, such as with account holders that occur less in the remittance business. Furthermore, in accordance with guidelines issued by competent authorities, remittance businesses should apply these measures, but may determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction.

Recommendation 7 is relevant for the settlements between remittance providers: remittance providers should, in relation to their cross-border relations, gather sufficient information about their counterparts abroad (in addition to performing normal due diligence measures).

Recommendation 10 requires remittance providers to maintain all necessary records on transactions and to keep copies of the identification data, account files and business correspondence for at least five years.

With respect to monitoring transactions, recommendation 11 requires that remittance providers should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose, and keep record of the background and purpose of such transactions. Recommendation 13 requires the reporting of suspicions of money laundering or terrorist financing to the financial intelligence unit.

Under recommendation 15 remittance providers are required to develop programs against money laundering and terrorist financing. Recommendation 21 advises remittance providers to give special attention to business relationships and transactions with persons from countries that do not or insufficiently apply the FATF recommendations.

Recommendation 23 instructs countries to ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the recommendations. Specifically that remittance providers should be licensed or registered, and subject to effective systems for monitoring and ensuring compliance with national requirements to combat money laundering and terrorist financing.

SR VII and SR IX also cover aspects of remittance systems as well as applying more broadly to other areas. SR VII requires, inter alia, money remitters to include accurate and meaningful originator information (name, address and account number) on wire and funds transfers and related messages that are sent. The information should remain with the transfer or related message through the payment chain. FATF has set a threshold of \$3,000 for a transitional period.

SR IX requires countries to have in place measures to deal with the transportation of cash and bearer instruments across the borders. This recommendation can indirectly affect remittance providers in those circumstances that they use cash couriers to settle their balances.

### Requirements in Sample Countries for Regulating Money Remittance Providers

	U.A.E.	U.K.	U.S. (Federal)	Switzerland	Germany	the Netherlands
<b>Regulatory system (number of registered/licensed)</b>	1) Hawaladars: voluntary registration (123) 2) Exchange houses: licensing (108)	Registration (1500)	Registration (22,000)	Licensing - if turnover over CHF 2 million or gross income over CHF 20,000 (200)	Licensing (43)	Licensing (30)
<b>Authority</b>	Central Bank	Customs	FIU & Tax authority	SRO or ML supervisor	Financial supervisor	Central Bank
<b>Capital/guarantee</b>	1) No 2) AED 2 million	Not required	Not required	Not required	Not required	Bank guarantee for outstanding amount
<b>Required legal structure</b>	1) Not required 2) UAE national for sole proprietorship or 60% owner for corporation	Not required	Not required	Not required	Commercial partnership or a corporation with 2 managers	Not required
<b>Fit and proper</b>	1) Not performed 2) Performed	Not performed	Not performed	Performed	Performed	Performed
<b>Experience</b>	1) Has to be existing hawaladar 2) Required	Not required	Not required	Required	3 years managerial experience required	Not required
<b>Criminal records</b>	1) Checked, no consequences 2) Checked	Checked, no consequences	Not checked	Checked	Checked	Checked
<b>Business plan / AML program</b>	1) Not required 2) Required	Not required	AML program required	Required, internal procedures	Detailed business plan required	Required for integrity issues
<b>Offsite information</b>	1) Quarterly, all transactions 2) Monthly balance statements	Annual turnover	No reporting	No reporting	Quarterly	Monthly
<b>Onsite visits</b>	1) Friendly visits 2) Once per year	Risk-based	Risk-based	On occasion, reliance on audit reports	On occasion, reliance on audit reports	Two to four times per year
<b>Identification</b>	1) All transactions 2) Transactions over AED 2,000	Transactions over €15,000	Transactions over \$3,000	All transactions	Transactions over €2,500	All transactions
<b>Suspicious transaction reports</b>	Required	Required	Required when trans. is over \$2,000	Required, based on founded suspicion	Required	Required
<b>Threshold transaction reports</b>	Not required	Not required	Transactions over \$10,000	Not required	Not required	Transactions over €2,000
<b>Record keeping</b>	1) Not required 2) All trans. over AED 2,000	5 years	5 years	10 years	6 years	5 years
<b>Sanctions</b>	1) None 2) Revoke, restrict license	Fines up to GBP 5,000	Civil and criminal fines	Warnings, order, withdraw license	Warnings, order, withdraw license, fines	Warnings, order, withdraw license, fines
<b>Fees on entry</b>	None	GBP 60 per premise	None	None	€1,000	€3,000
<b>Annual fees</b>	None	GBP 60 per premise	None	None (SRO membership)	Percentage over annual turnover (min €650)	€3,000 + percentage over annual turnover
<b>Other costs</b>	1) None 2) Annual audit	None	None	Annual audit	Annual audit	Annual audit