

Creating a Fair Playing Field for Consumers:  
The Need for Transparency  
in the U.S.-Mexico Remittance Market

Appleseed

*Sowing the Seeds of Justice*



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# Report Summary

The business of moving money across borders has grown rapidly and, as the market has matured, it has become increasingly competitive. The money flowing from the United States to Mexico currently represents the largest remittance market in the world. Just over 10.2 million Mexican immigrants live in the United States, comprising approximately 30 percent of the total immigrant population.<sup>1</sup> At the current rate of growth, these immigrants are expected to send over \$20 billion to Mexico this year and spend an estimated \$948 million in fees and other costs getting it there.<sup>2</sup>

As the volume of remittance transactions has increased, the number of companies offering money transfer services between the United States and Mexico has mushroomed from a couple of dozen to more than 150 today.<sup>3</sup> Competition has played an important role in bringing down pricing, particularly in the U.S.-Mexico remittance market. For example, in 2001, sending \$300 to Mexico using MoneyGram's remittance service cost \$25.<sup>4</sup> By 2005, the average cost to send \$300, using the same service, declined 42 percent to \$14.59.<sup>5</sup>

In recent years, there has also been a limited increase in pricing transparency. The standard for the U.S.-Mexico market is to print the exchange rate for the transaction, the upfront fee, and the amount to be received in pesos on the receipt. However, gaining access to the exchange rate prior to initiating a transaction and effective comparison shopping can be cumbersome or even impossible for consumers.

Pricing transparency has long been an issue of concern for consumer advocates, but it is also one that can help money transfer companies in the marketplace. Businesses that offer more competitive rates benefit from increased transparency because it makes it easier for consumers to identify low-price providers. Transparent pricing could also be a tool to create a general competitive advantage and reach niche markets. Businesses could generally benefit by an improved brand image, both within the specific markets they serve and in the broader policy communities that set standards and regulations that impact the market.

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<sup>1</sup> 2004 American Community Survey, U.S. Census Bureau.

<sup>2</sup> It is important to note that, according to the Inter-American Development Bank, remittances make up only 10% of senders' income. The other 90% stays in the United States. Inter-American Development Bank Multilateral Investment Fund, "Financial Inclusion & Remittances," June 2005.

<sup>3</sup> Jan Smith Ramos, "Latin American Remittance Markets: El Dorado is in Los Angeles" InfoAmericas Tendencias Industry Analysis, May 2002.

<sup>4</sup> Manuel Orozco, "Remittances as Development Tool," Paper delivered at the Inter-American Development Bank Conference, May 17-18, 2001, Inter-American Dialogue Washington, DC., <http://www.iadb.org/mif/v2/files/orozco.doc> (cited August 21, 2005).

<sup>5</sup> Based on data collected by Appleseed centers in Georgia, Illinois, Nebraska, and Texas between June 13 and June 24, 2005.

Despite many major improvements in the remittance marketplace as a whole, understanding what makes up the cost and being able to make a real cost comparison between companies remains a complicated endeavor and an important opportunity for differentiation.

To understand pricing dynamics in the international money transfer market place, Appleseed conducted a study of the cost to transfer money from the U.S. to Mexico in four different states: Georgia, Illinois, Nebraska, and Texas. When looking at pricing, it is important to examine the two components of the transfer cost, the fee and the currency exchange rate. The fee to send money is typically \$9 to \$10 on a \$300 transaction.<sup>6</sup> The cost from the exchange rate come from the exchange rate spread—an undisclosed difference between the price the company pays to purchase the foreign currency and the rate the money transfer company charges its customer to send the money.<sup>7</sup> The Appleseed study found that the exchange rate spread for transmitting money from the U.S. to Mexico comprised, on average, 37 percent of the total transaction cost, with consumers paying an estimated \$350 million in exchange rate fees for 2005.<sup>8</sup> The research found that the average exchange rate spread cost ranged between \$1.92 and \$10.80 on a \$300 transfer. The highest cost spread is 560 percent greater than the lowest cost spread for the same transaction.<sup>9</sup> Sometimes there is yet another fee to claim the funds. According to focus groups, this third fee tacked onto the back end of the transaction has consistently been an important consumer complaint about the industry.

The costs of sending \$300 to Mexico, which averaged approximately \$5.25 for the exchange rate fee and \$9.00 for the transaction fee, is significant, particularly in the context of the incomes of remittance senders and recipients. A 2003 study found that 46 percent of remittance senders had incomes of less than \$30,000 per year.<sup>10</sup> On the receiving end, 51 percent had monthly incomes of \$370 or less and 76 percent had monthly incomes of \$600 or less.<sup>11</sup> Receiving only \$5 or \$10 more per month because of savings in exchange rate and transaction fees could make an important difference for families earning \$370 or less per month.

Despite industry efforts to decrease costs, barriers to achieving true market pricing transparency remain. The exchange rate spread, for instance, proves much more difficult to quantify and understand for two reasons:

- Companies do not uniformly provide customers with the total transaction cost or the exchange rate *before* a transaction is completed.

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<sup>6</sup> *Ibid.*

<sup>7</sup> The Bank of Mexico daily exchange rate is used to approximate the rate at which the money transfer company purchases Mexican pesos with U.S. dollars.

<sup>8</sup> Results based on Appleseed data showing the average exchange rate spread of 1.75 percent for sending \$300 to Mexico, across all four markets surveyed (Georgia, Illinois, Nebraska, and Texas).

<sup>9</sup> The average exchange rate spread is based on average costs across all four markets studied.

<sup>10</sup> Multilateral Investment Fund of the Inter-American Development Bank, et. al., “Remittance Senders and Receivers: Tracking Transnational Channels,” November 2003.

<sup>11</sup> *Ibid.*

- As the official exchange rate moves, companies differ in how frequently they adjust the exchange rate they offer. Some make a same-day rate adjustment, some set one rate per day, and still others adjust the exchange rate weekly, twice per week, or make other periodic adjustments.

The lack of total pricing transparency in the U.S.-Mexico international remittance market hurts both consumers and the companies trying to provide low cost services. Consumers are hurt because they do not have the tools to compare transaction prices and find the optimal option for sending money. Companies offering lower transaction costs and exchange rate spreads are hurt because of the difficulty consumers face in consistently discerning low-cost providers and can incur consumer advocacy ire. Fluctuations in exchange rate pricing do pose a challenge for providing accurate total pricing disclosures, however there are options for improving the status quo.

Many studies have examined exchange rates in the U.S.-Mexico remittance market by collecting rates at one point in time. However, to fully understand the role exchange rates play in total pricing, it is important to examine rates over time and across markets. To provide a more complete picture of the impact of the exchange rate spread on pricing, four Appleseed Centers—Georgia, Illinois, Nebraska, and Texas—collected exchange rate data for wiring money to Mexico from 21 different remittance services, including multiple locations of nine services, at the same time, twice a day, over a two week period in June of 2005. These parameters made it possible to compare service pricing across geographic areas and between remittance service providers.

This study offers the remittance industry a look into market competition. It provides some recommendations on how market players can distinguish themselves by offering more transparent pricing, which will allow consumers to exercise their choices and reward providers that offer the best products.

## The Impact of Market Dynamics On Exchange Rate and Total Pricing<sup>12</sup>

Some of the variability in exchange rate pricing observed in this study, and presented in the next section, is tied to foreign exchange market dynamics. Businesses purchase currency at wholesale rates, but the rates vary depending on the time of day of the purchase, the amount of the transaction and the time of final payment for the transaction. There is also a degree of speculation in the marketplace, similar to the stock market, in which currency purchase decisions are made based on whether the purchaser believes the market will go up or down in the short-term. Therefore, each company is purchasing currency at different rates.

The exchange rate spread is also calculated in different ways depending on the business model and on the system for paying agents. Banks with their own in-house money transfer system can have a pricing advantage over non-bank money transfer operations because they do not have to pay agents on originating the transaction. They do have expenses tied to their interface with consumers on the originating side and may have revenue sharing arrangements on the destination side of the transaction. Banks can sell a variety of products and services to the consumer, offsetting some of the costs of offering the service.

Retail-based money transfer operations usually pay a percentage of the upfront transaction fee to the originating agent and a fee to the destination agent, which can be tied to the spread. Some destination agents, particularly banks, can charge more to the U.S. side bank or money transfer operation to distribute the money. This cost usually results in a lower exchange rate for certain pick up options in the destination country. The money transfer operation usually keeps a percentage of the upfront fee and the spread as profit. The amount the operation retains varies depending on the competition in the originating agent's community and on the destination agent.

Banks and money transfer operations each have their own systems for establishing spreads. Some offer consistent pricing, with a particular spread above the wholesale purchase rate. Others charge different spreads depending on their currency costs, other costs for the transaction and competition among agents in the originating and destination markets. Many businesses set one exchange rate per day in each market or across markets, but currently there is no particular standard in the marketplace.

A final issue that impacts transaction pricing is regulation on the operations side of the business. Stricter standards to prevent money laundering could impact pricing for all market players. There is particular concern among money transfer operations that stricter capital requirements and standards tied to prevention of money laundering could increase pricing in the long-term by pushing out of the marketplace the very players who have brought prices down: the smaller businesses that have sprung from particular immigrant

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<sup>12</sup> The information in this section is based on interviews with international money transfer service providers.

communities. Recently, there has been concern among banks that holding accounts of money transfer operations and their agents, which tend to be cash-intensive small community stores, could make them more vulnerable to sanction under the Bank Secrecy Act. This concern has led to account closures for some money transfer operations and their agents. There is also concern among smaller market players that the larger players are merging with their main competitors, consolidating market share, and pushing out smaller players through exclusive contracts with chain retailers that dominate local markets.

The different structures and forces that impact exchange rate and total transaction pricing are important to consider in any disclosure or market standards. They explain some of the variations in pricing found in the report. They also highlight the need to establish workable standards for transparency in the marketplace and to address other areas of industry concern that could impact recent trends of reduced costs for consumers.

# Key Findings: Challenges Facing Consumers Remitting Money to Mexico

The natural variations of currency exchange markets can only explain some of the exchange rate variability observed in this study. In many instances, the variability in rates appeared to move beyond expected fluctuations. To compound difficulties for consumers in determining total transaction pricing, exchange rates for transactions are not easily available. Of the 46 locations of 25 companies in the initial survey pool, eight were removed because of difficulties in accessing exchange rate information. Six of the companies refused to provide exchange rate information and two did not know how to access the information. The inconsistent availability of pricing information and exchange rate variations that cannot be explained by fluctuations in the currency value keep the market from operating efficiently for these primary reasons:

## 1. Lack of Marketplace Transparency

The market's complex pricing structure prevents comparison shopping and makes it nearly impossible to choose the most cost effective money transfer service. This is especially troubling since the cost of sending money—even with the same company or on the same day—can vary substantially.

- The cost to transfer money can vary dramatically even if the consumer uses the same business consistently. Appleseed found that the difference in cost—within the *same company*—varied as little as \$1.52 or as much as \$13.84 during the two-week study.
- Inconsistent and erratic exchange rate pricing—even on the *same day*—can create quite a disparity in the same market. Appleseed found that, in Georgia, a consumer could have spent as little as \$3.88 or as much as \$21.90 on the same day in June to send \$300 to Mexico. That is an \$18 difference.
- Half of the money transfer service locations surveyed appear to give minimal weight to the Bank of Mexico daily exchange rate in their pricing decisions.

## 2. Lack of Consistent Access to Correct Pricing Information

Appleseed researchers had a variety of experiences in accessing exchange rate information. Some providers readily gave exchange rate information, while others were less prepared or less willing to share the information.

- Exchange rate information was sometimes not provided upon request. While not required by law, the failure to disclose exchange rate information prior to initiating a transaction makes it nearly impossible for consumers to effectively compare total costs among providers.

- Of the companies that provided information, some did not have ready access to exchange rates and others provided inconsistent information. In the Nebraska market, calls at the same time to different agents of the same companies yielded different exchange rate results.

### **3. Lack of Consistent Regulation or Standardized Pricing Disclosure Practices**

The confusion for consumers created by volatile pricing and inconsistent customer service is exacerbated by the lack of consistent regulation in the international money transfer market.

- Both Houses of Congress have re-introduced bills this year to require money transfer companies to disclose fees to customers.<sup>13</sup> To date, meaningful legislation lags behind rapid developments in the market.
- Most states regulate money transfer companies in some capacity, but few require consumer-oriented disclosures. State regulations for money transfer companies generally do not apply to financial institutions.

Clear pricing disclosures are routinely required for a variety of financial services. Lenders must provide a good faith estimate of interest rates and fees. Financial institutions provide information about interest rates and fees for certificates of deposit or savings accounts in a format that enables consumers to compare various products.

A standardized pricing structure would provide customers access to the full remittance price *prior* to the transaction. A customer might still choose to shop at the more expensive, yet more convenient, store—whether it is a gas station or a money transfer service—but would benefit from the additional information that disclosures would provide.

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<sup>13</sup> See the International Remittance Consumer Protection Act of 2005.

# Positive Market Practices to Promote Pricing Transparency

This study has revealed major barriers in understanding the pricing of remittances, but there are also positive practices in the market today. Through the survey of remittance providers there are a number of best practices worthy of noting that address the clear disclosure of costs.

## **Consistent Customer Service**

Some companies in the Appleseed survey provided polite, prompt, and detailed information on all aspects of remittance costs, including exchange rate information, to researchers. In Texas, Orlandi Valuta stood out for such service. In Nebraska, service excellence tended to correlate with the local agent offering the remittance services rather than with the remittance company itself. These companies and agents had well-trained, knowledgeable staff, who encouraged potential customers to understand all of the costs in the remittance transaction.

## **Automated Access to Exchange Rate Information**

Some companies have completely automated the sharing of exchange rate information. Wells Fargo, for instance, has an automated 1-800 number that provides the current exchange rate, allowing potential customers to shop or wait until the exchange rate spread reaches the most favorable rate before sending money. On-line based wire transfer products also give consumers good access to pricing information. Making clear exchange rate and pricing information available to consumers at the point of service should be possible, given the capacity of companies to make such information available both over the telephone and on the Internet.

## **Guaranteed Pricing Parameters**

One of the main challenges for consumers in determining the cost of sending money internationally is that pricing within one service provider is not consistent. On one day, a service may offer the lowest price, and on another, the highest price. As a result, consumers who want to find the best prices cannot choose and stick with a single provider; they would have to monitor prices cross the market each time they make a transaction. The FedACH International Mexico Service has a guaranteed fee and exchange rate structure that lets consumers know exactly what they are paying for the service. The cost per transaction for the financial institution is only \$.67 and customers are guaranteed a .21 percent exchange rate spread, and deposit in a designated Mexican bank account by the next business day. Financial institutions may charge a fee above the \$.67 transaction cost. The weakness of this program is that it requires the remittance recipient to have a bank or credit union account. According to a 2003 survey in Mexico, remittance recipients are more likely to have a bank account than the population as a whole; 33 percent, compared to 22 percent.<sup>14</sup> However, 33 percent is still a relatively low number and indicates that a majority of

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<sup>14</sup> "Receptores de Remensas en México," Inter-American Development Bank, Multilateral Investment Fund, and the Pew Hispanic Center, October 2003.

remittance senders currently would not benefit from this product. The same survey showed that 67 percent of remittance recipients have banks in their communities, which means that there is still enormous untapped potential for the FedACH product.<sup>15</sup> Despite the current low bank participation rates of remittance recipients, the FedACH nonetheless provides a significant standard for international remittance markets. The pricing parameters are a good model for how complete pricing information can be provided to consumers in a constantly changing exchange rate environment. It also presents an interesting option that money transfer companies could use in transfers to Mexico to simplify some of the market dynamics that impact the industry.

### **Low Pricing of Remittance Services as a Way to Cross-sell Products**

Bank of America, through its SafeSend product, has aggressive in marking down the price of its remittance services to attract new customers. By eliminating the transfer fee, their product is the cheapest option currently on the market that does not require the recipient to have a bank account. Bank of America also announced that it will offer the interbank exchange rate on SafeSend transfers to Mexico.<sup>16</sup> The bank's goal is to use this product as a loss leader, making it enticing enough to consumers to encourage them to use the bank's other services. Such an approach has potential to benefit both consumers and financial institutions. By becoming involved in the banking system, consumers have a safe place to keep their money. They can better control their savings and build a good credit history and a healthy financial future for their families in the United States. Financial institutions benefit in the long-term through profits of providing additional services, including accounts, credit cards and loans. It has yet to be shown whether or not this strategy will be successful in attracting long-term immigrant customers. Currently, Bank of America carries only a small market share in the Mexican money transfer market.

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<sup>15</sup> *Ibid.*

<sup>16</sup> Anthony Harrup, "Bank Says It's Not in Remittance Market," *Associated Press*, October 5, 2005.

## Recommendations

### **1. Encourage the industry to provide customers with easy access to exchange rate and cost information.**

In a competitive business climate, companies that present clear and accessible pricing information to customers can create market advantage over those that do not. Low cost providers can use transparency as a marketing strategy for gaining new business and loyalty. By setting clear pricing disclosure standards for their industry, providers will improve market efficiency, and likely eliminate some of the exchange rate volatility that results from marketing as opposed to market forces.

### **2. Implement consumer-oriented federal oversight of international money transfers.**

The remittance market is the only financial market of its size without uniform regulation. Without creating unnecessary burdens on remittance companies, federal regulators could require vendors to provide consumers with disclosures that enable consumers to make meaningful cost comparisons among the products available in the marketplace.

This disclosure approach is in line with disclosure and cost computation requirements under the Truth in Savings Act, the Truth in Lending Act and the Electronic Funds Transfer Act. In the context of remittance markets, providing access to the total cost of a remittance transaction, including exchange rate fees, is necessary in order to provide consumers with the basic tools to compare the transaction costs of different money transmitters.

As a strategy for determining the most effective way to provide consumers with accurate and comparable pricing information for international remittance transactions, the U.S. Congress could create a blue ribbon commission comprised of industry and consumer representatives. The commission would be responsible for recommending a regulatory framework that is workable for the industry and provides consumers with the necessary pricing information. It could also address industry concerns that impact competition in the marketplace.

### **3. Create a system of voluntary market standards for fair remittance pricing practices.**

Voluntary market standards have been effective in other markets, including the Fair Trade coffee program and logos indicating no animal testing for cosmetic products. Such an approach can be created through a dialogue with service providers and consumer advocates.

In order to be successful, this approach would require the creation of a set of standards that would assist consumers with pricing information, yet be practical for money transfer company compliance.

Companies meeting those standards would display a logo or other identifiable information. Consumers would be guaranteed basic standards in the remittance pricing structure. Companies would gain a positive reputation among consumers for their fair pricing practices and reduce the likelihood of lawsuits that could result from opaque pricing policies. Such a program would need to be launched in conjunction with organizations that work closely with and have the trust of remitting communities. It would also include outreach and advertising so that consumers understand both the value and the reliability of the program.

“Fair Exchange” remittance standards could focus on pricing basics such as:

- A guarantee that the exchange rate spread would be no more than one percent;
- Clear disclosures on a receipt of the transaction fee, exchange rate, and amount in foreign currency to be received;
- A guarantee that no additional fees will be charged on the receiving end; and
- A guaranteed date and time when the money will be available.

These changes would build greater transparency—economic efficiency and consumer protection—into the remittance market.

Building on the results of this study, Appleseed will work with stakeholders to further evaluate the option of creating voluntary disclosure standards for international remittance providers. We aim to establish a set of standards that are acceptable to both money transfer service providers and organizations representing consumers and to work to take this concept from an idea to a market reality. Once the standards and the vehicle for enforcing the standards are established, we will work to encourage the necessary collaborations between community and industry organizations to implement the project model. Voluntary market standards have been successful in altering both industry and consumer behavior, primarily for consumer retail and agricultural products. Some recent successes in the financial services context demonstrate that they can be both an effective and market friendly alternative to increased regulation.