Family Remittances and "De-Risking"
The Case of Mexico

By Salvador Velázquez B.

Mexican migrants in the USA are first class Mexicans. They are in general the risk-taker population, hardworking, with a different work ethic compared to the average American worker. They give a different value to their labor and the remuneration that they receive for that effort. Some are prosperous entrepreneurs too. Success stories abound throughout the US. They are far removed from the political campaigns in Mexico, in which they are included, to their regret, in the political speeches with highly demagogic and populist content. They are generally skeptical of the political agendas of migrant associations in the USA. For these reasons, among others, they are most likely to repudiate acts of corruption. They are also highly reasonable users (consumers) of the electronic remittances market.

They migrate looking for an initial point of contact, usually a close relative, who gives them their first support and probably a first job that serves as an "induction course" to the American work culture. From there, they move to any part of the Union in constant search for better jobs; that is why we will always find Mexican labor in virtually all the 50 US states. At that moment is when migrants experience the first need to send money to their homeland. It is likely that the first remittance will be partly used to pay for their travel expenses (expenses of the "pollero"[1]) and partly to give initial support to their families. They are also absolutely wise in their spending decisions, savings and consumption of services.

As a result of the threats that the new US government is expressing, enfolded under a shifting outlook more akin to a surrealist drama, statements that call for “unity” against possible measures have emerged in Mexico. As it is already in the public domain, one of these "initiatives" of the Trump Administration is to tax remittances particularly to Mexico and other Latin-American and Caribbean countries, to prevent undocumented migrants from having access to the service.

The viability of some of these initiatives remains to be seen. However, in the search for spaces that require us to converge on unity, it is necessary to address the danger that has already existed for some years over the Mexican remittances payment sector.

[1] A pollero is slang for the person you ask to get you across to the United States. It's slang for people smuggler. Also, they are usually called coyotes if the crossing involves walking through the desert.

De-Risking (note 1) (fundamentally globalized) in Mexico and the world

The year 2011 was possibly the most important development for this issue in Mexico, when US financial crime authorities concluded a period of investigation leading to a historic fine of nearly two billion dollars to **HSBC ($ 1.92Bn)** in 2012; the causes of such penalties are fundamentally associated with money laundering. It surprised the entire international financial community, and the public in general, the weaknesses of their internal controls, anti-money laundering and terrorist financing procedures, among others, made public in the US regarding a massive and important global institution such as HSBC.

Like domino tiles, the world's major banking institutions set themselves on the task of reviewing their processes and initiating the withdrawal from businesses they considered high-risk; among them, the business of paying remittances in receiving countries. Almost all global banks have important operations in Mexico where they had (and have) presence through its subsidiaries or branches. Likewise, companies (MSBs) that originate remittances both in the United States and in the rest of the world were, and continue to be, subject to extraordinary pressure by the great global financial institutions with the closing of bank accounts everywhere. This global phenomenon has been called *"de-risking".*

In the electronic money transmission business, a fundamental part of the value chain is the phase corresponding to the payment of remittances. In other words, it is the "last mile" that brings the funds, hard-earned money, to the families of migrants. Without this last portion, the reception of the funds to the families could not be possible.

Therefore, in my opinion, it is of the topmost importance, to tackle the de-risking problem in a decisive manner.

Although the Central Bank in Mexico (*Banxico*) does not disclose this information specifically, we can assume from interviews with market participants that it is very likely that approximately 90% of remittances in Mexico are being paid in cash. A smaller portion is paid through account deposits and in a reduced number using other means like Money Orders or cash deliveries[2]. The fundamental reason for this has to do with the low index of financial inclusion of the adult Mexican population. According to the World Bank, in its Global Findex 2014 **(note 2),** for the case of Mexico, only 39% of the adults had some type of account in some Financial Institution. The causes for which Mexico is a country with very low financial inclusion rates are multifactorial. However, I just want to concentrate on one of these factors: the inability of large banking institutions, mostly the ones under foreign control, to understand the needs of the C2, D and E segments[3] and therefore their ineffectiveness to

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[2] Cash that parents or Friends take when they travel

[3] Niveles Socio Económicos en Mexico http://nse.amai.org/nseamai2/

design products aimed at those segments which are at the base of the social pyramid in Mexico.

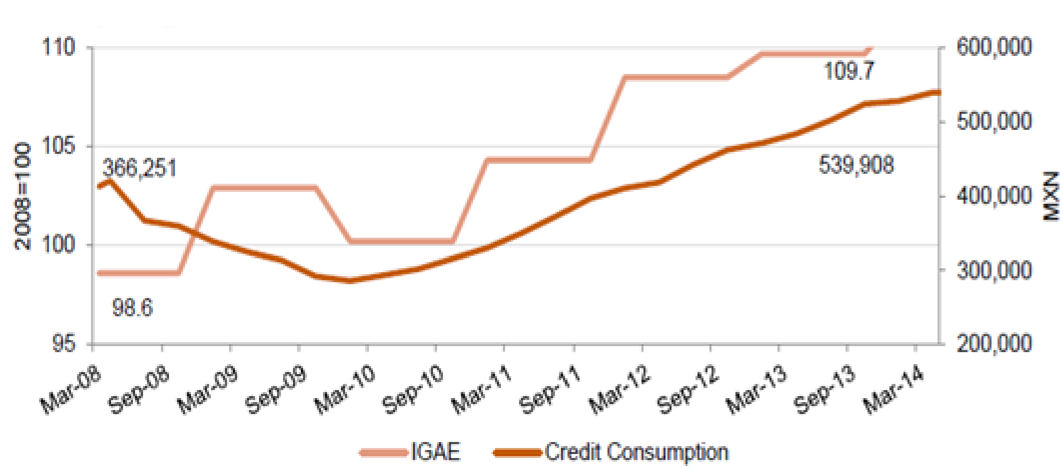
Let's analyze the problem. Mexican financial authorities have among others, the mandate to promote the financial inclusion of the population:

For the World Bank, financial inclusion occurs *"... when businesses and individuals have access to affordable financial products and services that respond to their needs for transactional, payments, savings, credit and insurance, all in a sustainable and responsible manner .... Access to an account that allows individuals to perform elementary transactions is the first step to gaining greater inclusion. "*

Few studies and papers on Banking Institutions in Mexico make an assessment on their fundamental function as payment networks and not only as savings and loans entities. For the electronic remittance industry, such networks were an efficient way to make funds accessible to families of migrant workers in Mexico, which is one of the countries with the lowest indexes of branches per capita with respect to the world average [note 3];

The government and bank officials who shaped the sale structure of the Mexican banks, once domestically controlled, to foreign capital gave them control of the Institutions and did not take into consideration the probable risks that sovereignty entailed. We just have to analyze the global credit crisis of 2008, in which the big global banks significantly reduced their activity of placing consumer credit in all the countries where they had presence, regardless of the fact that in those countries there were no causes to justify such decisions. This was particularly true in Mexico from 2008 to 2010, as can be seen in the following graph:

Index of Consumer Credit granted by Mexican Banks in MXN millions (2008-2014) compared to the General Index of Economic Activity (IGAE) [note 4]



With only a simple analytical exercise, economists of the Mexican governments in the 1990s should have realized that an oligopolistic banking system in foreign hands (such as the one that currently exists in Mexico) could pose serious risks to the performance of the economy of the nation. History unfortunately has confirmed it. In the framework of NAFTA, the sale of the banking sector was negotiated in the late 1990s.

The negative externalities that were generated:

The Mexican banking sector, throughout the 20th century, built an important network of branches to cover most of the national territory. Today, their growth has been nearly halted (approximately 50% of Mexican municipalities do not have a bank branch). The network of bank correspondents has tried to cover this coverage weakness with limited results.

For banks, paying remittances through their branches is a marginal business that was growing and had great potential. For the banks that are still paying remittances and the ones that are no longer, it amounts to:

1. A business that generates high transactional revenues with zero financial risks. (By its nature banking requires the taking of financial risks in order to produce income)

2. It is a natural source of dollars for their exchange desks which they use to hedge positions at lower costs compared to other interbank market participants

3. It is a business that generates a natural source of new customers in untapped population segments. With virtually null investment in marketing or advertising, those new segments, that need all kinds of financial services, can be attracted to the bank.

4. Once banked (and financially included) they become highly productive segments for the bank in the medium and long term. It is a target market that generally does not demand high rates for its savings, nor sophisticated banking services and that just requires a safe place to keep its savings. And this is besides the transactional needs, credit, insurance, pension services, etc.

The most important operating costs involved in the business of paying family remittances to banks are practically marginal or zero-related. As with consumer credit in the years of the financial crisis (2008-2010), banks have now closed their branch networks to family remittances. Notwithstanding the business rationale outlined above, ignorance (or arrogance or both) and the lack of sensitivity of Global Banking Institutions to the local needs most of them headquartered in New York, London, Madrid, Toronto, etc., have decided to pull out their subsidiaries in Mexico, and other countries, from the business of paying remittances to the families of Mexican migrants in the USA. The exceptions are the banks with a predominance of Mexican capital ownership (Banorte, Banco Azteca, Banco

Famsa, etc.), but nevertheless, together they represent a small percentage of the total banking branch network in Mexico (probably less than 30%).

Furthermore, an even more serious threat is the elimination, by these foreign global institutions, of commercial relations (correspondent accounts) with those banks or non-banks that have decided to continue with the business of paying remittances in Mexico and other countries.

This means that the market for payment of remittances, that was previously open to open competition is gradually being transformed into an oligopolistic business with serious current and potential future damages for the consumer, the institutions and the Mexican economy. Remittances won't stop, but it becomes a business more difficult to supervise, to regulate and with a great tendency to move into informal channels. Transaction costs are already rising due to lack of competition in the market; therefore, Global banks are in a way creating artificial entry barriers for new competitors.

In those countries where local regulations prevent foreign banks from exercising absolute control over the capital of banks and local financial institutions, the de-risking phenomenon seems to have been less perverse (Guatemala, Colombia, Ecuador, Brazil to name a few) up to now.

It is, hence, a question of excluding competitors, probably breaching the concession title granted by The Mexican State and as a consequence, creating an environment of oligopolistic competition and price control. Given this worrying scenario, it is surprising that the Mexican Money Transmitter Industry has not made itself loudly heard in front of the financial authorities. The situation will probably keep on deteriorating.

Mexican financial authorities have expressed some concerns on this regard but, in my opinion, in a rather timid way. Neither the SHCP[4] (Mexican Department of Treasury) nor the CNBV[5] (Mexican Federal Banking Commission) nor the Central Bank (BANXICO) nor CONDUSEF[6] (Mexican Financial Services Consumer Protection Bureau) nor CoFeCE[7] (Mexican Federal Trade Commission) nor any other national entity have expressed their position, at least publicly, on this issues, so harmful to the remittance industry[8]; and at the end of the day in the detriment of Mexicans living in the USA that we must consider its first class citizens.

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[4] Secretaría de Hacienda y Crédito Público (SHCP)
[5] Comisión Nacional Bancaria y de Valores (CNBV)
[6] Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros (CONDUSEF)
[7] Comisión Federal de Competencia Económica (CoFeCe)
[8] And not only to the remittance industry but also to microfinance institutions (see note on "additional information")

CONCLUSIONS

If all the Mexican regulatory agencies need the drive to act, President Trump is giving them the push needed. Several international multilateral organizations such as the World Bank, the IDB, even the US authorities (FinCen) and other bodies such as the G20 and non-governmental organizations have been warning of the risks to the industry that the large banking networks withdraw from the money transmission business and de-risk everyone associated with it.

In summary, the most important risks I perceive are:

1. The cost of sending money home will rise again and reach the price levels that existed in the 80's and 90's

2. Encourage the use of informal channels with their inherent risks

It is my conviction that the financial authorities must responsibly command the financial industry to do their homework and to do what the law mandates. Mexico has to take the lead in front of the global banking community. De-risking is affecting , besides Mexico, entire economies in the world. Creative solutions must be found to prevent payment networks that have been built for decades from ceasing to play their primary role, which is to bring bank services closer to the general population.

Moreover, as fintech business consultants for firms establishing or growing financial services and products, or developing projects in Mexico, we are witnessing how the de-risking phenomenon is also affecting innovation in this sector, which is a matter of great concern to the Mexican economy. De-risking can eliminate at the root those technological and market solutions that energize the economy and generate new job opportunities.

Mexico received in 2016 from of its workers in the US close to 27 billion dollars. We cannot continue to be insensible to the problem.

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Notes:

1. De-Risking: It is the term that has been used to describe the phenomenon by which large global banks (and some local banks) are closing or drastically limiting the relationship of banking businesses with their business clients. This phenomenon results from the application of central policies or directives that limit the exposure of banks and their subsidiaries in the world, to market sectors perceived as "high risk". In this classification, among many, the money transmitters, remittance service providers, foreign exchange firms, exchange centers, Sofomes, FinTECH firms, etc. This tendency is also the results of avoiding over-concentration in a given industry, in the access policies of correspondent banking, limiting or eliminating its off-shore operations, cash, foreign exchange houses and activities, among others. It is, in summary, an action by the global banking system that implies completely eliminating a risk when it is perceived that the cost of assuming the risk is higher (with payment of fines and lawyers and reputational risk) than the income received for fees, exchange spreads and future banking clients).

2. World Bank-Global Findex. Is the percentage of respondents who report having an account by themselves (or in co-ownership through someone else). The account can be with any bank or financial institution, mobile account for adults over 15 years.

3. In Mexico to September 2016 there were 1.9 branches per 10,000 inhabitants. This index has not undergone any major variation in the last five years. Source: National Council for Financial Inclusion and CNBV (Mexican Banking Commission) it is the lowest indicator of the OECD countries.

4. Published by PWC México (April 2015) "*Retail Banking in Mexico-An Industry Outlook*" with figures from Banco de México and INEGI

Additional Information:

• In March 2016, the Association of Banking Supervisors of the Americas (ASBA) based in Mexico published a document entitled " **Compliance/Regulatory Risk in Financial Activity (De-Risking) In The Americas**" - http://bit.ly/2uV7mwm - on a survey conducted by ASBA, which received responses from 25 of its Associate Members, including Mexico. According to supervisors in the region, the PSCs that are most prone to de-risking are remittances (60%), followed by Correspondent Banking, (40%), trade finance (28%) and currency exchange (12%).

• On October 2016 El Economista published an interview with Claudia Revilla, general director of the microfinance network ProDesarrollo, who stated that she has documented 236 cases of the closing of bank accounts of microfinance institutions and that the network wants the National Commission for the Protection and Defense Of the Users of Financial Services (CONDUSEF) to denounce these "discriminatory acts" by the banks. Http://bit.ly/2eGT6kn