



Testimony of

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Chairman

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Before the

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Committee on Financial Services'

Subcommittee on Domestic and International  
Monetary Policy, Trade, and Technology

On

**Remittances: Access, Transparency, and Market Efficiency**

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Chairman Gutierrez, Ranking Member Paul and distinguished members of the Subcommittee. On behalf of Microfinance International, thank you very much for including me in today proceedings. It is good to be back with the Subcommittee and Committee again. Much of what I know today about development and banking, I learned during the eight years I worked as legislative counsel to this Subcommittee (for both Democrats and Republicans).

First, I would like to commend the Chairman and the Committee for their focus on these important issues. Busy companies within the industry and their regulators do not stop often enough to consider the interests of the consumers of remittance services. As we all know, families, communities, countries and entire regions of Latin America are highly dependent on these flows, and we must ensure that remittance architecture works smoothly and efficiently and that consumers are being given a fair deal. This is an important role ideally suited to the Congress.

I am here today representing Microfinance International Corporation (MFIC). The company's mission is to expand affordable and professional financial services to new markets where services have been overpriced or disconnected from mainstream banking. We are based here in Washington, DC, in the United States but work with financial institutions across 20 countries in Latin America on remittances and other financial services.. Our approach combines microfinance methodology with a commercial banking approach in a for-profit model, enabling us to offer financial services in a manner that is self sustainable, scalable and socially responsible.

You have asked me to address a set of questions revolving around the costs of remittances, issues of compliance and the adequacy of transparency within the industry. I think the best way for me to answer these questions is to briefly describe how MFIC's remittance platform operates, because it differs in important ways from systems with which you may already be familiar. Later in my presentation I will comment on other questions and point to some of the weaknesses in the current compliance regime and suggest one way to improve it.

### A Different Vision

Microfinance International began from a starting point different than most remittance companies. Our concern was with the agonizingly slow progress toward economic development in many parts of Latin America. We saw what must be described as the failure of large scale development projects and programs to make a significant difference in the lives of poor people. We saw U.S. immigrants being forced to pay exorbitant fees for very basic financial services that any long time U.S. resident would have considered usurious. We saw a lack of competition among money transfer companies, and a fee structure that typically took 10 percent of the amount being remitted, counting both commissions and foreign exchange rates. We saw the formal U.S. banking system turn a blind eye to immigrants' legitimate need for loans, insurance and other products longtime residents take for granted.

Existing remittances systems had their weaknesses. Commercial banks, dependent on the SWIFT transfer system and their correspondent relationships, were a slow (2 days) and

expensive (\$35) choice for handling remittances. Additionally, banks are typically located in larger cities in developing countries and this limited their ability to serve remittance receivers who more often live in rural areas. At the same time, most traditional money transmitters relied on a system of agents on both ends of the transaction. In the modern era, this has proven to be an uncomfortably high cost structure and presents significant obstacles in ensuring regulatory compliance.

MFIC also started with some tremendous advantages. The project was conceived by a senior international banker with three decades of experience in Latin American and other international markets. Second, the company began operations after September 11, 2001, at a time when it was abundantly clear that attention to compliance would be critical to the firm's success.

The heart of the MFIC model is its advanced remittance platform. It is Internet-based and contains a quick and easy interface, enabling us to charge low fees and guarantees smooth transactions. Senders can book and receive remittances at any of our wholly owned and operated shops or at an allied financial institution. Transactions take place at the speed of light, such that the receiver can collect the funds seconds after they are placed. Much of the required regulatory compliance elements are checked automatically in real time by the system, which also provides compliance guidance to the teller electronically. A "Help Desk" located in El Salvador can step in quickly if a remittance appears to have gone astray.

Most of our remittances are paid out at microfinance institutions and banks with such programs in developing countries. These institutions are happy to partner with the company because remittances bring new customers to their doors with money to save or invest in other products. In fact, much of the company's overall approach is based on microfinance principles proven long ago to work in impoverished countries, where clients are not very financially literate and lack credit histories.

The leap in technology with associated lower costs enabled MFIC to drop remittance prices to well below the norm. When we opened operations in Central American, the average cost of sending a \$300 remittance was about \$15. We began by charging \$9. Today the average is around \$10.

### MFIC's Remittance Platform

I mentioned that our system was designed with compliance very much in mind and that many features are automated within the system. Here is how it works. A client comes in wishing to send \$300 to a relative in (say) Honduras. He presents an ID card to the teller who records his name, address, telephone number and the information on the recipient of the funds. While the client is waiting, the system checks his identity against the Treasury Departments list of problem individuals (OFAC SDN list) and other government lists of designated nationals. If there is a match, the remittance transfer is frozen instantly until the case is investigated by a compliance official.

At the same time, the system checks each remittance transaction for suspicious activity following a sophisticated SAR-matrix that aggregates transactions across all locations and screens them against a wide set of criteria to detect suspicious patterns. The system flags suspicious transactions and others that might exceed limits set by us or by regulation. Any time a suspicious match is found, our compliance officer receives a computerized printout that also list any and all related transactions. At this stage, unless the compliance officer knows there were reasonable explanations for these occurrences, (s)he would file a suspicious activity report (SAR) as required under the Bank Secrecy Act.

This system is now working very well within our nine shops in Washington DC, Delaware, Maryland and Virginia. Recently we began making the system available as a turn key platform to commercial banks and other money transfer companies who are seeking greater efficiency and the need to improve their compliance.

### The Current Shakeout in the Remittance Industry

It is important to know that the remittance industry is in the middle of a shakeout largely caused by heightened compliance requirements. Many smaller remittance companies have found it difficult to comply with new regulations because they lack a system to do this. Many have chosen to sell their operations to more sophisticated remittance companies or close their doors.

Regulators also inadvertently contributed to the disruption in the industry. In late 2005, regulators issued guidance to commercial banks warning that money service businesses were “high risk businesses” and told them that they should take steps to more closely monitor the activities of any MSB clients. To most banks, this added regulatory responsibility was not worth the profits derived from a handful of small MSB clients and most leading national and regional banks closed existing MSB accounts and adopted a policy of no new ones.

In retrospect, this episode is seen by many in the banking industry as an attempt by regulators to force commercial banks to do their work for them – to take on the supervisory responsibilities assigned to the regulatory agencies. However, the plan backfired when banks decided it was not worth the added work and dropped their MSB clients, forcing some MSB to go underground. Regulators backtracked and announced it was OK for banks to maintain accounts for well-managed MSB clients, but by this time, much damage was already done.

MFIC itself faced the closing of its bank accounts at some banks, and the company had to scramble to find a bank willing to listen long enough to hear and understand our story. This is particularly ironic because we have no doubt that our own compliance system is superior to theirs in tracking remittances.

### Patterns of Remittance Costs

Studies by noted remittance expert Manuel Orozco and the InterAmerican Development Bank show that remittance fees charged to consumers have come down markedly in the last 10 years. [See charts that follow]. We see two main causes. First, the IDB and other multilateral

institutions turned a bright spotlight on the remittance industry, which had operated for many years out of sight of the public and federal regulators. The IDB initiated a public discussion of the high remittance costs, attracting new entrants into the industry who were seeking the high margins then prevailing. Ultimately this new competition helped bring costs down. Second, the U.S. Treasury Department and other major finance ministries publicly called for lower fees and ultimately the G-8 Finance Ministers issued a joint communiqué on the subject.

Some figures on remittance cost patterns follow:

[Text resumes on the following page]

Number of Remittance Companies Operating in Selected Countries: (Source: M. Orozco, International Flows of Remittances, 2006)

	2001	2002	2003	2004.01	2004.11	2005.12
Bolivia			18	18	16	14
Colombia	4	16	37	37	40	29
Cuba	2	12	10	9	7	5
Dominican Republic	30	36	34	31	32	25
Ecuador		13	34	18	16	19
El Salvador	21	26	24	29	20	15
Guatemala	22	30	32	30	23	14
Haiti	5	10	18	14	10	7
Honduras		16	20	20	20	12
Jamaica	7	7	8	13	11	6
Mexico	25	49	69	51	58	56
Nicaragua	13	14	16	11	6	6
Peru			23	24	17	13
Venezuela			18	10	11	8

Cost of Remittances to Selected Countries (Source: M. Orozco, 2006)

	2001	2002	2003	2004.01	2004.11	2005.12	01-05
Ecuador		5.7	5.1	5.4	4.4	3.9	1.8
Peru			6.2	5.5	6.1	4.6	1.6
Colombia	10.1	8.7	6.0	6.5	5.9	5.0	5.1
Nicaragua	7.5	7.5	7.0	6.9	6.7	5.2	2.3
Venezuela			7.4	8.6	6.5	5.2	2.2
El Salvador	6.7	6.2	5.8	5.7	5.0	5.2	1.5
Guatemala	7.4	7.3	7.8	7.1	6.3	5.6	1.8
Bolivia			10.1	8.2	6.7	5.6	4.5
<b>LAC with out Cuba</b>	<b>8.6</b>	<b>7.8</b>	<b>7.7</b>	<b>7.4</b>	<b>6.4</b>	<b>5.6</b>	<b>3</b>
Honduras		6.9	6.9	7.2	6.2	5.8	1.1
Mexico	8.8	9.3	7.5	7.5	6.2	6.0	2.8
LAC	9	8.6	8.2	8.3	7.1	6.3	2.7
Dominican Rep.	9.4	8.4	7.2	8.8	7.1	6.4	3
Haiti	9.0	8.1	10.4	8.9	7.9	6.7	2.3
Jamaica	9.8	10.0	12.7	10.2	8.8	8.2	1.6
Cuba	13.0	12.9	12.4	12.1	12.4	12.0	1

## Transparency

Transparency has been an issue within the industry, but here again, competition has helped improve the situation. We have all heard many unhappy stories where consumers have been lured to a particular remittance provider by the offer of low fees on the deposit end, only to find that the remittance receiver has to pay huge foreign exchange or other fees to withdraw funds in local currency on the other end. In many instances remitters are not told how much local currency they will receive for the money transferred and the money transfer company later applies a foreign exchange rate that is substantially different from the one shown at the time of the transfer.

This is an area where the ‘buyer needs to beware.’ We know that Chairman Gutierrez has considered legislation to bring more transparency with respect to foreign exchange fees charged to remitters. MFIC would fully support any reasonable requirement for more transparency because it can only aid the consumer and well-intentioned and competitive remittance companies.

However, this is a difficult area in which to legislate for a number of reasons. First, the cost of foreign exchange is driven by the market forces and varies from day to day; from place to place; and from buyer to buyer. A huge company like Western Union can buy foreign exchange at wholesale rates. In contrast, small remittance companies are forced to acquire foreign exchange at retail rates, which can be higher by a percentage point or more.

Our customers tell us they are satisfied when they are given the exact amount the recipient will receive in local currency. This allows them to make comparisons and ensure that their transfer will cover the need of the recipient. Accordingly, our receipt shows the amount of the remittance, the fee we charge them, the FX rate applied and the ultimate amount that will be delivered to the recipient in foreign currency. The company guarantees the exchange rate in effect at the time of the remittance and published to the remitter, and as a result carries the exchange risk until the transaction is completed.

## Toward A Better Compliance Regime

Finally, I would like to offer some comments on the current compliance regime and suggest some ideas that may prove to be a better approach for all over the longer term. We read the testimony from last week’s hearings at this Committee on the cost to banks and MSBs of complying with the Bank Secrecy Act<sup>1</sup>. I was struck by what seemed to me to be whining by industry and self-serving statements by regulators. Of course, there is always tension between industry and regulators and this is natural and probably good. However, I was also disappointed not to see more innovative suggestions for improvements.

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<sup>1</sup> Hearing title: Suspicious Activity and Currency Transaction Reports: Balancing Law Enforcement Utility and Regulatory Requirements. May 10, 2007. U.S. House of Representatives Committee on Financial Services, Subcommittee on Oversight and Investigation.

No one disputes the need for regulation to stop terrorist finance and criminal money laundering. Every American individual and financial service firm sincerely wants to stop money laundering and block terrorist finance to the maximum degree possible. The question is how this can best be done.

My personal view is that regulators took the wrong tack in their haste to respond after 9/11. Essentially they chose to deputize American financial institutions and to make them part of the supervisory apparatus responsible for the pursuit of criminals and supporters of terrorism. Commercial banks and money service businesses were and are ill-equipped for this role, and they have been struggling ever since to meet regulators expectations in a cost effective way.

Take for instance the filing of suspicious activity reports (SARs). Banks and others have learned that no matter how conscientious they are in filing SARs, if they fail in one instance to spot suspicious activity and file a report, examiners are very, very unforgiving. Huge financial penalties have resulted. Now, it has become common practice for financial institutions to engage in “defensive filing” of SARs at every possible juncture so as to avoid the possibility of making a mistake. The result of this is a badly clogged system. Many SARs are never even examined by regulators and authorities waste precious time looking over completely benign transactions.

Additionally, there is also a so-called “silo” problem. Each financial institution and remittance company can be diligent in checking its own database for repetitive remittances of a suspicious nature, but none of these databases are linked. Each is an individual silo. So then, what happens when a criminal books one transaction with MoneyGram, another with Western Union, a third with MFIC, etc.? None of the individual institutions would be in position to note any suspicious activity.

A better system would have banks and MSBs submit a list of all transactions over a specified threshold to the appropriate regulatory authorities. Then, government could mine that data, looking for patterns of suspicious activity. They would quickly find those patterns of transaction that are invisible to individual companies no matter how diligent they are. This would all have the salutary effect of taking financial service companies out of the policing business, an activity for which they are not well suited.

Thank you very much, Mr. Chairman for this opportunity to present our views. We look forward to working with the Committee in any future efforts related to these topics.

Required Biographical Information for:

James C. Orr  
Chairman, MicroFinance International Corporation

Mr Orr has worked in government and the private sector in finance, development and international trade for 40 years. His principal occupation is Executive Director of *The Bretton Woods Committee*, a group of 650 corporate chief executives, former cabinet officials and other prominent Americans who have joined together to improve understanding and help increase the effectiveness of the World Bank, the International Monetary Fund and other global and regional development institutions.

In 2003, Mr Orr was elected Chairman of *MicroFinance International Corporation*. MFIC is a diversified financial services provider dedicated to offering high quality, affordable services to underserved markets and where services have been overpriced or disconnected from the mainstream banking system. Products range from unsecured micro-loans for consumers with no credit history to transnational loans enabling immigrants to buy homes and start small business loans in their home countries. MFIC operates a robust, Internet-based remittance platform which is highly compliant with federal regulations.

In 1983, he founded *James Orr Associates* where he oversees the firm's operations on behalf of domestic and international clients in the financial services industry and international business more generally. He works closely with Congress, federal departments and financial regulatory agencies. Prior to the formation of the firm and the Committee, Mr. Orr served both Republicans and Democrats during eight years as legislative counsel to the House Financial Services Committee and the International Trade and International Development Subcommittees in the U.S. House of Representatives. He has an undergraduate degree in economics from Wesleyan University and a master's degree in international economics from the School of Advanced International Studies (SAIS), Johns Hopkins University.

Mr. Orr also serves on the Board of Directors of *TechnoServe, Inc.* – a non-profit, aid organization helping entrepreneurial people in developing countries build businesses and create employment, income and opportunity for their communities.

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“Truth in Testimony” Disclosure, required by the Committee on Financial Services:

Neither Mr. Orr nor Microfinance International Corporation has received any Federal grants or contracts, either in the period since October 1, 2004 or prior to that date.