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Remittance Rules: A Case Study of Regulatory Pitfalls

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The Dodd–Frank financial regulation statute requires nearly 400 rulemakings.[1] As of January 2, some 60 percent of the rulemaking deadlines were missed, and a full third of the required regulations have not been proposed.[2] The delays may defer some compliance expenses. However, regulatory uncertainty also imposes costs on businesses as well as consumers, as the saga of the "remittance"[3] rules illustrates.

The term *remittance* refers to the tens of billions of dollars transferred electronically each year from U.S. residents to relatives and friends abroad. These remittances totaled nearly $52 billion in 2011—the largest such outflow worldwide.[4] The majority of U.S. transfers are routed to Mexico.[5] These cash infusions constitute a major source of income in many developing countries. Indeed, remittances to poor nations total three times the amount of official development assistance.

As transfers have grown, so, too, have remittance services, which are now available from banks and credit unions; wire services such as Western Union and Money Gram; big box retailers such as Wal-Mart; and "digital wallets" such as PayPal. They may be conducted in person, by telephone, or online.

Unnecessary Regulatory Crackdown. Most states require money transmitters to obtain a license.[6] But the Dodd–Frank act in 2010 granted broad authority over remittances to the new Consumer Financial Protection Bureau (CFPB), including:

- Strict standards of disclosure for fees, exchange rates, taxes, and the net amount of currency to be delivered to a recipient;
- Error resolution rights for customers;
- Recordkeeping rules;
- Cancellation/refund policies; and
- Liability of service providers for acts of their agents.

The CFPB issued a set of sweeping regulations in February 2012. CFPB officials characterize the new regime as a "comprehensive new system of consumer protections." But there is little evidence that consumers were ill-served under state licensing. Indeed, the fees for electronic transfers have been steadily dropping as service options have multiplied. The emergence of Internet transfers has also enabled consumers to compare fees and other terms of service, thereby reducing their costs. As is often the case, market competition and advances in technology have already accomplished the regulatory objectives set by Congress.

In response to the proposed regulations, the bureau received dozens of letters warning that the proposed rules were unworkable. A letter to CFPB director Richard Cordray signed by 32 Members of Congress characterized the regulations as "arbitrary" and urged the bureau to "undertake a comprehensive study of their impact before moving forward to avoid irreparable harm to consumers."[7] However, no major changes were made to the final regulations, resulting in rules that conflict with the realities of remittance transactions.

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Numerous Regulatory Flaws. The final regulations require service providers to disclose in writing, both before and after a consumer pays for the transaction, all fees and taxes, as well as the exchange rate. They must also document the precise amount of the remittance to be collected by the foreign recipient.

All of which might seem reasonable—provided that transfer agents can determine at any point in time the precise local, regional, and federal tax rates for dozens of countries, the fees charged by an array of service providers worldwide, and the ever-changing exchange rates. That is a particularly difficult burden for small businesses.

The regulations do provide an exemption for insured "depository institutions," which may use estimates in the disclosures if the precise amount of fees, taxes, and rates cannot be determined (through no fault of their own) until after the transaction is completed. The exception is slated to expire on July 21, 2015. Congress authorized regulators to extend the exemption for an additional two years, but the CFPB has declined to do so.

The regulatory exemption for banks and credit unions will put small and independent service providers at a competitive disadvantage. Yet it is the depository institutions that are arguably better positioned to determine foreign taxes, bank fees, and exchange rates.

In comments on the draft rules, financial institutions and trade groups stressed to the CFPB that there is no reliable method to determine in advance the exact amount of provincial, regional, and local taxes and fees for every remittance around the globe. Transfer payments do not always travel directly from point A to point B; many involve circuitous routes through intermediaries in more than one country. Service providers do not necessarily have a standing business relationship with all the various transfer agents, and the remittance costs will vary depending on location, time, and other factors. Nor are monitoring services always available overseas, as they are in the United States.

The remittance regulations also impose various obligations on service providers to investigate and remedy transfer errors. Errors may include late delivery of a transfer, delivery failure, or the remittance of an incorrect amount of money. The final regulations effectively presume that all errors are the fault of transfer agents; no provisions were made for consumer error despite industry warnings of potential fraud.[8]

The final rules left service providers scrambling for ways to somehow comply with the new requirements. Others simply canceled remittance services. For example, the Federal Home Loan Bank of New York decided to halt international wire transfers because of the "looming regulatory hurdles being placed on this service."[9]

Careless Rulemaking Reconsidered. Ten months after finalizing the regulations, on December 21, 2012, the CFPB announced its intention to "refine" three elements of the remittance rules. Officials touted the move as "designed to facilitate

1. Davis Polk, "Dodd-Frank Progress Report," January 2013, http://www.davispolk.com/files/Publication/7191edca-f4ed-4460-a514-01ca9d3cf8b9/Presentation/PublicationAttachment/63d52126-7e7f-477a-b47c-08e8acfe145e/Jan2013_Dodd.Frank.Progress.Report.pdf (accessed January 14, 2013).
2. Ibid.
3. The phrase "remittance transfer" includes cash or prepaid card deposits, consumer funds transferred between domestic and foreign banks and other financial institutions, and payments from U.S. consumers for goods or services provided by businesses overseas. The regulations do not apply to payments from corporations.
4. World Bank staff calculation based on data from IMF Balance of Payments Statistics Yearbook 2011 and data releases from central banks, national statistical agencies, and World Bank country desks. The figure is conservative, reflecting only formal recorded remittances.
5. Ibid.
6. Bureau of Consumer Financial Protection, "Electronic Fund Transfers (Regulation E); Final Rule and Proposed Rule," *Federal Register*, Vol. 77, No. 25 (February 7, 2012), pp. 6194–6309, http://www.gpo.gov/fdsys/pkg/FR-2012-02-07/pdf/2012-1728.pdf (accessed January 14, 2013).
7. Barbara S. Mishkin, "House Members Urge Postponement of Remittance Rule," Ballard Spahr CFPBMonitor blog, August 20, 2012, http://www.cfpbmonitor.com/2012/08/20/house-members-urge-postponement-of-remittance-rule/ (accessed January 14, 2013).
8. For example, a customer could complete a transfer payment but later claim (erroneously) to have provided an incorrect account number. The service provider would be liable for a refund even if the recipient picked up the funds from the "wrong" account.
9. News release, "FHLBNY to Stop Processing International Wire Transfers at Year-End," Federal Home Loan Bank of New York, November 20, 2012, http://www.fhlbny.com/news-events/press-releases/prior-releases/2012/press112012.aspx (accessed January 11, 2013).

implementation" and to "provide additional flexibility."[10] In reality, the revisions are necessary only because of the CFPB's careless rulemaking.

The revisions proposed by the bureau, if implemented, address some of the more problematic aspects of the regulations. For example, service providers without specific knowledge of fees imposed by a recipient's institution for receiving a remittance transfer would be permitted to (1) rely on a sender's representations regarding these fees, (2) estimate by disclosing the highest possible recipient institution fees that could be imposed, or (3) rely on other reasonable sources of information.

The bureau is also proposing to require only the disclosure of federal taxes, and not regional, state, provincial, or local taxes. In the absence of specific information about federal taxes, service providers would be allowed to estimate by disclosing the highest possible foreign tax that could be imposed.

Revisions to the error resolution provisions have also been proposed. In the event a sender provides an incorrect account number, the service provider would still have to attempt to retrieve the remittance but would not be liable for the funds if those efforts were unsuccessful.

Regulatory Arrogance. The remittance regulations constitute rulemaking at its worst: protracted uncertainty, overly broad strictures that reflect a misunderstanding of the targeted market, and fewer, more costly consumer options. Dozens of experts in the finance industry attempted to warn the CFPB about the flaws before the rules were finalized. Reflecting no small amount of regulatory arrogance, the agency ignored the input—only to reverse course.

Unfortunately, the remittance rules saga is not isolated. Dozens of other Dodd–Frank provisions remain unwritten or stuck in regulatory or judicial limbo, leaving financial institutions and their customers uncertain about their investment and credit options. It is a sorry reminder of how poorly crafted legislation and ill-considered rulemaking have costly consequences.

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10. Consumer Financial Protection Bureau, "Remittance Rule Implementation (Subpart B of Regulation E)," November 27, 2012, http://files.consumerfinance.gov/f/201211_cfpb_remittance-rule-bulletin.pdf (accessed January 11, 2013).