The Dodd-Frank Act and Its Impact on U.S. Remittances

Globalization is leading to a surge in international remittances worldwide. Yet until recently, regulators only indirectly addressed these monetary transfers. Section 1073 of the Dodd-Frank Act will dramatically change this – providing direct, substantive regulation of the industry worldwide.

Executive Summary

The United States is among the biggest destination countries for international migrants, and by far the largest source country for international remittance. The U.S. Bureau of Economic Analysis and World Bank reported that worldwide remittance flows, including those to high-income countries, reached US$501 billion in 2011, and are expected to increase to US$615 billion in 2014. Apart from prohibitions on financial interactions with countries such as Cuba and Myanmar, U.S. regulators have only indirectly addressed these monetary transfers. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) significantly alters this – maintaining direct regulation of the industry for the first time.

Over the next decade, the remittance industry will change greatly due to the increasing types of service providers and transfer business models, the expansion of mobile-phone ownership, and the extension of mobile signal availability. These changes will further fuel the beneficial role that remittances play in international economic development.

In this white paper, we will assess the impact of the Dodd-Frank Act, Section 1073, on the U.S. remittance industry, and address concerns related to corresponding banking models.

We will also describe centralized payment and hub-based solutions for large banks – leveraging Cognizant’s experience with financial institutions and corporate transaction banking in the U.S. market. Additionally, we will discuss the functional, system and process-level changes that will need to be incorporated by banks and related financial services institutions (FIs) to achieve compliance with the Act.

The Dodd-Frank Act (Section 1073 – Regulation E)

The Dodd-Frank Act Section 1073 amends the existing Electronic Fund Transfer Act (EFTA), which:

- Requires disclosure of certain information prior to and at the time of the transfer.
- Creates new consumer protections, including the right to cancel a transfer and the right to a refund under certain circumstances.
Establishes a new error-resolution scheme to which remittance transfer providers must adhere.

Sets standards of liability for remittance transfer providers and their agents.

Under the new rule, the term “international remittance transfer” largely refers to electronic transfers of funds sent by U.S. consumers to recipients in foreign nations, including consumer-to-consumer (C2C) low-value money transfers greater than US$15, as well as consumer-to-business (C2B) transfers. The new rule became effective as of October 28, 2013.

The rule covers small-value transactions (greater than US$15) and electronic transfers in large dollar amounts (high-value payments). It is not limited to consumer transactions; it also extends to cover any electronic transfer for any kind of goods purchase. The remittance includes transfer by any electronic payment mode, like automated clearing house (ACH) transfers, international wire transfers (SWIFT), prepaid cards, etc.

All entities that offer remittance transfer services, such as banks, money transmitters and credit unions, should be prepared to meet the requirements of the Dodd-Frank rule. These specify:

Before the consumer finalizes the transaction, the bank will need to disclose the up-front fees and taxes, the exchange rate applied, fees charged by the bank’s agents abroad and intermediary institutions, and the amount of money expected to be delivered to the recipient.

A receipt that includes the fee disclosures, along with the date of the delivery of funds and, if appropriate, a disclaimer that additional fees and foreign taxes may apply.

A transaction cancellation window of 30 minutes with a full refund.

Investigation of disputes and error remediation.

Originating institutions are to be liable for the acts of their agents and authorized delegates.

Remittance: Current Scenario
Existing remittance processes lack transparency on charges, as well as the exchange rate provided to a customer (see Figure 2). The remittance process initially introduced by banks...
included “plain vanilla” transfer products that gave customers no visibility into their charges and exchange rates. However, with increasing competition, banks were motivated to develop products to alleviate this problem. Yet other parameters, such as FX remittance, continued to lack transparency. Consequently, customers who conducted remittances were unaware of value dates, fees deduction, charges and taxes.

Remittance Post Dodd-Frank
Following implementation of the Dodd-Frank Act, banks are now required to build systems that provide full disclosures to customers, as illustrated in Figure 3. In the first step, the bank must furnish full information on remittance to the consumer before a payment transaction is initiated. In the second step, the customer will confirm the remittance after agreeing with the full disclosure data. Failing to do so will result in the underlying payment being cancelled. The third step – funding payment transaction – is then initiated.

Error-Handling Under Dodd-Frank Regulation
If a remittance transfer provider receives notice from a sender within 180 days of the promised date of delivery that an error has occurred, the provider is to investigate the error and resolve it. Within 90 days of notice, the provider is to refund the entire amount of the transfer or the deficient amount, provide another remedy that the Consumer Financial Protection Bureau may determine by rule, or notify the sender that there was no error, with an explanation.

Responsibility of Remittance Transfer Providers for Agents
Remittance transfer providers will be held responsible for violations by their agents or authorized delegates when they are acting for the remittance transfer provider. Enforcement agencies are permitted to consider in any enforcement action the extent to which a remittance transfer provider maintains policies and oversees procedures for ensuring compliance by agents and delegates.

Achieving Dodd-Frank Compliance
While the processes under Dodd-Frank appear to have only one additional step for showing disclosure data, in practice, implementation is much more complicated. What banks must do is not just disclose data, but also ensure that disclosure is accurate and in compliance. Further complicating the situation is that the data inside the disclosure comes from disparate systems.

Most banks need to build a central hub for remittances, which integrates all relevant data, as well as the tracking and reporting system needed to store and report it. This means banks must:

- Review current disclosures and disclosure practices, and plan implementation of updated disclosures pending clarification of various disclosure requirements.
- Review and revise procedures for determining exactly or, if permitted by the Act, estimating the foreign currency amounts to be delivered to transmission recipients, including accurate determination of exchange rates to be used to support compliance with disclosure requirements.
Remittance Post Dodd-Frank

- Reveal compliant notices to be displayed at physical locations and on Internet sites, documenting costs and proceeds of sample remittance transfer transactions, pending adoption of such requirements by the Consumer Financial Protection Bureau.
- Implement updated error-resolution procedures to meet associated record-keeping requirements pending rules to be adopted by the Consumer Financial Protection Bureau.
- Review or adopt written policies and procedures for ensuring and monitoring compliance with the Act and regulations pursuant to the Act by agents and delegates.

Dodd-Frank Disclosure Compliance: Impacted Areas

Dodd-Frank impacts several bank systems in the remittance processing chain. The impact on functional components is depicted in Figure 4, page 6.

Dodd-Frank Data Hub

Banks can choose to meet Dodd-Frank disclosure requirements by modifying their existing internal systems. However, several of these might be involved in remittance processing, which increases the risk, time and cost of an upgrade. Alternatively, banks can choose to implement a service layer, or hub, for disclosure requirements, which will act as a data hub for disclosures. The purpose of this hub is to interface with other systems in the IT environment to help ensure that a smooth disclosure data flow is maintained — with minimal impact on existing systems — to achieve Dodd-Frank compliance.

The hub can interface with multiple remittance applications, as well as payment/foreign currency conversion applications within the bank. It can act as a centralized entity for holding payments until the client approves the disclosure data. The hub offers additional flexibility to the bank on both functional and technological levels to meet future requirements regarding centralized implementation of disclosure-related processes.

For smaller remittance providers, a hub may prove to be a costlier option than modifying existing systems. However, for larger banks with multiple products and systems, it is much safer and cheaper to have a de-coupled implementation. Additionally, for banks that act as correspondents or white-labeled partners of smaller banks, a hub offers added flexibility to pass on disclosure data to smaller banks (e.g., FI clients).

The hub interacts with all the systems in the payment workflow to gather the disclosure data and present it to the customer, as shown in Figure 5 on page 7. The hub receives the remittance request from the channels, and collates the
Quick Take

Dodd-Frank compliance by the mandated date will require significant time and effort, and may warrant a range of measures across the organization.

| Channels | • Fetch and show Dodd-Frank disclosures to customer.  
| | • Process approval/cancellations in holding period.  
| | • Post (and update) notices of a model remittance transfer for one or more amounts, showing the amount that would be received using exchange rates on home or landing page.  
| Treasury Systems – FX Deal Booking System | • Accept FX deal booking from customers and provide data for disclosure.  
| Billing Systems | • Provide data on billing, fees and taxes for disclosures.  
| | • Ensure compliance with billing preferences confirmed by customer as part of disclosures.  
| Customer Information System | • Provide customer data required for disclosures and computation of rates/fees.  
| | • Validate before disclosure if the customer account falls under the Dodd-Frank Act.  
| Static Data Management Systems | • Provide holiday data for computation of value dates required for disclosure data. Maintain charges/fees/taxes by corresponding banks.  
| Core Payment System | • Ensure compliance between customers’ approved data and payment processing timelines.  
| | • Accept cancellation request if customers cancel within allotted 30-minute holding periods.  
| Audit Logging / Internal Tracking Systems | • Log approval and rejection steps taken by customer.  
| | • Maintain all transaction-related details to help in investigating errors reported by remitter.  

Disclosure data by interfacing with various systems inside the bank. The data hub also needs calculation algorithms to determine processing times, value dates, etc. The data collated and calculated is then presented in disclosure reports for the customer to approve/reject.

After confirming disclosure data, the hub forwards the remittance to existing processing applications and ensures adherence to remittance of disclosure data. It also helps to audit the disclosure workflow, and assists in legal compliance when multiple banks and a large customer base are being served.

Apart from white-labeling, auditing and handling implementation benefits, the hub helps the bank standardize disclosures and their approvals. Standardization assures that all channels present a consistent view of data and the experience of end customers.

Observations and Practical Considerations

Many remittance service providers have raised the following concerns around the scope and guidelines of Dodd-Frank.

- Given the broad scope of the Final Rule beyond the traditional remittance transfer transactions, implications will be far-reaching, since most banks do not currently collate data on FX rates and value dates in retail banking environments. Data elements, including billing, are only partially communicated to customers.
Addressing Issues and Challenges

Dodd-Frank presents several compliance-related challenges for remittance providers. Transactions within a bank can emanate from existing channels, or received through a correspondent bank. Listed below are some of the key pain points, as well as remedies, that can be employed.

- **Partner bank (third-party) transfers**: Third-party transfers are initiated by using the MT 101 route by banks. For example, a U.S. bank's channel can initiate payment on an account that is part of a smaller U.S. bank. This can result in a situation where the initiating bank is unable to disclose all the required details to the customer. One possible solution is to use Swift information messages to report details back to the initiating bank and hold the payment until a disclosure is received.

- **White-labeled channels**: These need to be modified to meet Dodd-Frank requirements for all the banks with which remittance providers work. Considering the aggressive timeline for implementation, white-labeling of Dodd-Frank compliant channels presents a business opportunity for early adopters.

• Compliance by the mandated date will require significant time and effort, and may warrant a range of measures across the organization. Several systems are affected, as shown in the QuickTake on page 5. Banks will also need to improve their internal operations' processes to ensure adherence to disclosed timelines.

• Many FIs assert that the regulation should not apply to transfers where the originating institution does not control the transfer from end-to-end, since the disclosure of fees/charges applied by intermediary institutions handling the transfer and taxes levied in the recipient country is not in control of the originating institution.

• Disclosure of the FX rate in a case where a transaction is initiated using a prepaid card is not practically viable. These types of transactions typically involve loading a card with funds and sending it to the recipient, who can use it like a debit card at an ATM, or to make purchases at point-of-sale terminals. Normally, the exchange rate for prepaid cards is determined at the time the card is used.
Exotic currency transfers: Most banks partner with external providers for third-party payments. Exotic currency payment channels provide rates and a value date for exotic currencies, since banks that operate them do not hold Nostro accounts in those currencies. Consequently, a third party operates fixed fees and value dates, in addition to bank fees. Channels, as well as currency providers, will need to be modified to address these requirements.

On behalf of payments (OBOP): These payments (initiated from FI channels) will require full disclosure to an FI that can pass it on to the end consumer. Consequently, FI FX transfer channels will require changes that will pass on all disclosures to the FI, which can then communicate the message to its customers.

Next Steps

Banks have three possible options for meeting Dodd-Frank requirements:

- Modify the existing system: One option for meeting Dodd-Frank requirements is to modify/upgrade existing applications to support the required process changes. Considering the impact of various regulatory changes, this may not be the best option, given that the cost of upgrading all systems will be very high and scalability-flexibility could be constrained.

- Build a data hub: Building a separate processing data hub to cater to disclosure and other processing requirements is one viable solution. As noted earlier, the hub will absorb maximum impact on the existing systems to advance compliance with the Dodd-Frank Act.

- White labeling: Banks can also avail themselves of white-labeling services from Dodd-Frank-compliant banks or a specialized service provider. This will help banks meet the strict timeline per guidance, and with minimum impact on existing systems.

While finalizing the solution for compliance, banks will need to consider the following:

- Time to market: This is very critical. Dodd-Frank compliance is a regulatory requirement, and delays may be unacceptable. Banks will have to decide on a solution that will be stable, and which can be implemented per the prescribed timeline.

- Cost of implementation: Banks will need to perform a cost-benefit analysis of all options, keeping in mind transaction volume, cost of implementation and maintenance.

- Solution scalability: There are many regulatory changes being introduced, including, FATCA$^2$ and BASEL III,$^3$ which will impact banking processes and the IT landscape.
Moving forward, there are likely to be additional regulatory changes that will have an impact on banking. Considering this, banks will need to select a solution that is flexible and scalable enough to accommodate their needs as the regulatory environment dictates.

- **Business vision:** Many banks and specialized service providers can shape business opportunities while deciding on solutions. Solutions can be offered to small players as a white-labeled service. Considering the impact of regulation changes and the timeline for compliance, this could represent a meaningful business opportunity, given that the larger transaction banks that are in compliance can extend the proposition as a white-labeled service to smaller remittance providers.

**Footnotes**


2. **FATCA** – The Foreign Account Tax Compliance Act (FATCA) is a United States statute that requires United States persons, including individuals who live outside the United States, to report their financial accounts held outside of the United States, and requires foreign financial institutions to report to the Internal Revenue Service (IRS) about their American clients.

3. **Basel III** (or the Third Basel Accord) is a global, voluntary regulatory standard on bank capital adequacy, stress testing and market liquidity risk.

**About the Authors**

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About Cognizant's Wholesale Banking Group

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