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Overseas Filipinos' Remittances: Regulatory Framework and Policy Directions

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Overseas Filipinos (OFs) undeniably play a vital role in the Philippine economy. The stock of OFs has averaged 7.8 million over a decade (1997-2007), with more than 50 percent classified as overseas Filipino workers (OFWs).[2] Inflows from OFs' remittances increase the foreign exchange supply available in the system to fund the foreign currency requirements of the economy and spur consumption expenditures. This, in turn, creates demand and expands domestic production. OFs remittances contribute significantly to economic growth, with its ratio to gross domestic product (GDP) reaching 10.8 percent in 2009.[3]

The remitted portion of OFs' income coursed through banks amounted to US$17.3 billion in 2009 or a year-on-year growth rate of 5.6 percent. The favorable growth amidst the global financial turbulence was attributed to sustained global demand for professional and skilled OFWs, as well as the improved monitoring of remittance flows. OFs' increasing access to formal channels for remitting funds to Philippine beneficiaries can be traced to technological innovations and wider remittance network of financial institutions. By 2009, only 3.5 percent of total remittances, from a high of about 25 percent in 2001, were coursed outside the banking system.[4]

As cross-border financial transactions, the transfer of funds from OFs to their beneficiaries in the Philippines are governed by varying laws, regulations, circulars and issuances that can be applicable to the institutions or individuals involved in a remittance transaction. Taking stock of a multi-dimensional set of regulations is a key step toward a dual purpose: (1) understanding the legal framework of OFs' remittances, and (2) improving the financial landscape through which funds are transferred from the remitter in the first mile up to the designated beneficiary in the last mile.

INSTITUTIONAL SETTING

A. Role of Monetary Authorities

1. Administrative Framework

The Bangko Sentral ng Pilipinas (BSP) provides mainly the financial regulations for fund transfers through formal channels such as banks, private remittance companies and other remittance agents. This authority finds legal basis in Republic Act No. 7653 dated 10 June 1993, also known as the New Central Bank Act, which empowers the BSP to supervise the operations of banks and to exercise such authority as provided in its Charter and other pertinent laws over the operations of finance companies and non-bank financial institutions performing quasi-banking functions, and institutions performing similar functions. Thus, activities of financial entities that engage in remittance operations are supervised by the BSP in accordance with the law and other enabling regulations.

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[1] Deputy Director, Department of Economic Statistics

[2] Data based on Stock Estimates of OFs by the Commission on Filipinos Overseas. OFWs refer to contract-based, including temporary and irregular, workers. Irregular workers are those working abroad with incomplete employment documents.

[3] GDP data based on the report of the National Accounts of the Philippines (NAP) for 2009.

[4] Estimates used in the Philippine balance of payments (BOP) compilation, partially based on the results of the annual Survey of Overseas Filipinos conducted by the National Statistics Office (NSO).

- **Foreign Exchange Rules and Regulations**

The BSP regulations on foreign exchange transactions have been consolidated in a Manual of Regulations on Foreign Exchange Transactions in July 2009, effectively replacing BSP Circular No. 1389 dated 13 April 1993. The following foreign exchange regulations directly relate to OF remittances, among others:

Disposition of Foreign Exchange Receipts. Foreign exchange receipts, acquisitions or earnings of residents from non-trade sources may be used freely for any purpose. Under a liberalized foreign exchange regime, individual bank clients including OFs and their beneficiaries may opt to retain their remittances in foreign currency deposit accounts.

Cross-Border Transfer of Foreign Currency. Any person who brings into or takes out of the Philippines foreign currency, as well as other foreign currency-denominated bearer monetary instruments, in excess of US$10,000 or its equivalent, is required to declare the same in writing and to furnish information on the source and purpose of the transport of such currency or monetary instrument.

- **Anti-Money Laundering Law**

The Anti-Money Laundering Act (AMLA) of 2001 created the Anti-Money Laundering Council to investigate covered and suspicious transactions, and money laundering activities.[5] The threshold for covered transactions, or a transaction in cash or other equivalent monetary instruments, amounts to ₱500,000.00 within one banking day. Covered institutions under the AMLA refer to banks, non-banks, quasi-banks, trust entities, insurance companies, securities dealers, foreign exchange corporations, money changers, money payment/remittance/transfer companies, and other entities dealing in currency, commodities or financial derivatives, cash substitutes and other monetary instruments or property. While the ₱500,000.00 threshold is considered high for the average amount of individual remittances, AMLA regulations remain relevant for bulk remittances coursed through banks and other financial institutions.

- **Banking Laws**

Section 5 of the amended General Banking Law (GBL) empowers further the Monetary Board of the BSP to prescribe ratios, ceilings, limitations, or other regulations on the different types of accounts, including those of OFs, and on practices of banks and quasi-banks which shall, to the extent feasible, conform to internationally-accepted standards.[6]

Section 53 authorizes banks, quasi-banks and trust entities to receive funds in custody and act as financial agents for the account of their customers.

Section 59 grants the BSP full authority to regulate the use of electronic devices and processes for recording, storing and transmitting information in connection with the operations of a bank, quasi-bank or trust entity, including the delivery of services and products to customers by such entity.

The GBL allows the BSP to formulate policies that would oversee the types of platforms used for remittances (e.g., phone or internet banking) and foreign currency deposit (FCD) accounts maintained by OFs. Banks are required to seek prior BSP approval before they can provide electronic banking services,

[5] R.A. No. 9160, as amended by R.A. No. 9194 dated 7 March 2003; the Anti-Money Laundering Council is comprised of the BSP, Insurance Commission and the Securities and Exchange Commission.

[6] Republic Act No. 8791 dated 12 April 2000

including fund transfer applications for remittances.[7]

To address the increasing use of internet banking for sending money to beneficiaries, the BSP issued minimum prescribed guidelines on correspondent banking and electronic fund transfers.[8] The BSP's guidelines also adopted the AMLA's "know-your-customer" (KYC) policy to prevent money laundering activities. In 2005, the BSP issued circular letters to banks to adopt electronic monitoring system on money laundering activities, strictly implement their KYC policies, and notify the BSP of financial products offered by branches and subsidiaries of foreign banks in the Philippines.

- **Regulations on Non-Bank Financial Institutions (NBFIs)**

NBFIs are a diverse group of financial entities regulated by the BSP composed of private remittance companies, money transfer operators or remittance agents. The BSP also recognizes the NBFIs as part of the formal channels as funds transferred through NBFIs utilize the banking system, mainly through their deposit accounts in correspondent banks.

No interest rate ceilings are imposed on NBFIs and banks. Unlike banks, NBFIs are not regulated by a common legislation granting them specific authorities to engage in financial services.

The BSP issued Circular No. 471 dated 24 January 2005, requiring all foreign exchange dealers, money changers and remittance agents to register their operations with the BSP. This regulation provided equal opportunity for the remittance players in the industry and enhanced the country's compliance with international anti-money laundering regulations. In effect, the Circular also widened the AMLC's institutional coverage.

2. Statistical Responsibilities

The BSP's mandate to produce data and maintain statistical frameworks for banking and external accounts indirectly influences the regulatory framework on remittances, particularly with respect to the periodic bank reporting system. R.A. No. 7653 provides the BSP's two-fold function of data compilation and economic research as guideposts for the Monetary Board in setting and implementing its policies. Such data consist of compiling the country's balance of payments, including foreign exchange transactions reported by the banks through the International Transactions Reporting System (ITRS). The ITRS represents an electronic platform where remitting banks transmit daily reports on sources and disposition of foreign exchange, including OF remittances.

Apart from the BOP compilation, the BSP's electronic-based reporting system for banks serves the regulatory purpose of monitoring deficiencies in reserve requirements and foreign currency deposit unit (FCDU) cover, among others. The dual reporting requirement allows the BSP to validate the accuracy and completeness of foreign exchange transactions reported by banks.

Moreover, commercial banks have their own tagging systems that can identify OFs' accounts for statistical purposes and for granting special incentives, e.g., exemptions in service charges and zero maintaining balances.

B. Role of Fiscal Authorities

Prior to the liberalized FX regime, the Philippine Overseas Employment Administration (POEA) required overseas contract workers, through their private manning agencies, to remit to their beneficiaries a certain percentage of their basic salary abroad, to be exchanged for pesos through the Philippine banking system (POEA Rule VIII). Such rule has been superseded by a POEA rule requiring private manning agencies to automatically remit 80 percent of the basic salary of seafarers

[7] BSP Circulars No. 240 and 269 dated 5 May and 21 December 2000, respectively
[8] Circular No. 436 dated 18 June 2004

without compelling the workers to exchange the FX for pesos.

Tax exemption is one of the rewards provided by the government to OFs to recognize their valuable contribution to the national economy. The Tax Reform Act of 1997 or R.A. No. 8424 provides tax breaks to OFs, including OFWs. Section 23 of the law states that a non-resident citizen will be taxed only on income derived from sources within the Philippines. Filipinos overseas are thus exempted from paying taxes on their earnings from foreign sources.

Revenue Regulation (R.R) No. 10-98 exempts nonresidents and OFWs from payment of taxes on income derived from FCDs.[9] Interest income actually or constructively received by a resident citizen of the Philippines on interest income from FCD shall be subject to a final withholding tax of seven and one-half percent. However, nonresident citizens who have FCD accounts are exempt from paying taxes on interest income derived from said deposits. For bank accounts that are jointly in the name of a nonresident citizen or OFW and his spouse or dependent who resides in the Philippines, 50 percent of the interest income from the bank deposit shall be treated as exempt while the other 50 percent shall be subject to final withholding tax. To be entitled to this exemption, the nonresident individual or OFW should open the FCD account in his/her name.[10] The nonresident citizen or OFW should also execute a written consent for the depository bank to inform the Commissioner of the Bureau of Internal Revenue that he/she is a nonresident, exempt from the tax on income from FCD. A depositor who fails to comply with this requirement shall not be entitled to the said privilege.[11]

Given the tax exemption on FCD, the OFs could thus choose the currency and instrument with which to keep their remittances, whether in FX or pesos, and regular bank account or FCD. Other factors, such as the bank's proximity and security, may also be considered by the OFs as some workers also keep a part of their income in bank accounts abroad.

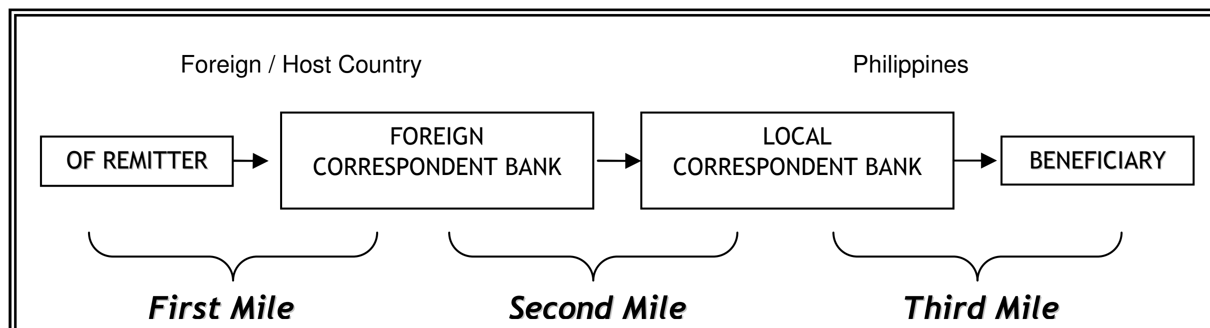
POLICY DIRECTIONS

The Philippine government authorities strive on improving the overall environment for OFs through sound regulatory policies that promote the efficient use of remittances. Specific agency mandates designate the Department of Labor and Employment (DOLE), POEA, and Overseas Workers Welfare Administration (OWWA) to manage the continued recruitment, deployment, training and well-being of OFWs in host countries, as well as the National Reintegration Center for OFWs (NRCO) for the workers' eventual return to the Philippines.

The BSP, on the other hand, has identified various initiatives that are anchored on four main principles of: (1) enhancing transparency and competition in the remittance market; (2) improving access to financial services; (3) encouraging OFs and their families to increase savings and investment; and (4) promoting financial learning among OFs and their beneficiaries.

[9] Bureau of Internal Revenue (BIR) R.R. No. 10-98 dated 25 August 1998
[10] With any valid document on immigration, residency or employment presented to the bank
[11] Under the Bank Secrecy Law (R.A. No. 1405) observing confidentiality of customer information

Remittance Flow Process:



The regulatory framework on remittances broadly relates to the specific initiatives under the four principles. Direct linkages, however, are strongly manifested in the second principle of improving access to financial services, as this pertains to a vital pillar of central banking, i.e., the efficiency of the country's payments and settlements system.

Regulations that focus on the payments and settlements system also facilitate a smooth and efficient remittance flow process. This would not only encompass the last mile or the domestic financial infrastructure, but would also extend to the first two miles in foreign territories, insofar as global interconnectivity of financial systems is concerned.

Remittance-receiving countries thus continue to devise specialized systems that promote more efficiency in terms of faster delivery time and lower service fees. Modern information technology plays a major role, particularly electronic banking products or alternative mechanisms for sending money. Several modes of remittances include internet-based remittance, use of mobile phones for performing financial transactions utilizing the short messaging system (SMS) or text feature of cellular phones for balance inquiry, fund transfer, withdrawals (cash-out), and interconnection of automated teller machines. Some banks also offer card products with debit features to facilitate remittances with financial institutions as issuers and telecommunication companies as service providers. These new modes generally cost less both for the remitters and the beneficiaries. Estimated time to remit is also faster, with the growing trend toward real time fund transfers.

In the BSP's case, a joint project has been undertaken with banking associations to establish a local clearinghouse for credit-to-other-banks mode of remittances. Local receiving banks have previously hired the services of courier firms to expedite the feedback of beneficiary banks in crediting remittance transactions. The receiving banks pay the couriers a range of Php100-Php550 for their delivery service to other banks. The project involves electronic settlement of OFs remittances through the BSP-Philippine Payments and Settlements System (PhilPaSS).[12] The BSP will only charge Php5.00 for each transaction or 90 percent lower than the current fee structure.[13] As the banks migrate to the new system, the banks' back-end processing fee will be reduced to Php50.00 for each OF remittance transaction.

Apart from the system capabilities, monetary authorities' policies also tend to promote access of households to the products and services of financial institutions. A balanced approach is clearly important, where policies

[12] Project proponents from the banking industry have signed the Memorandum of Agreement (MOA) for the joint project on 2 December 2009, with full systems implementation targeted by the first quarter of 2010. Currently, however, several banks have experienced delays in migrating to the new system due to hardware and connectivity issues.

[13] To encourage local banks to migrate to the PhilPASS Remit System, the BSP will not charge service fees until November 2010.

work on both ends — from the viewpoints of the financial sector and the beneficiary households. A fine example is the BSP's grant of FCDU license to qualified rural and cooperative banks. Prior to March 2006, only universal, commercial and thrift banks were allowed to operate FCDUs. With the regulation authorizing rural and cooperative banks to open FCDU accounts, OFs' beneficiaries in the countryside now have the option to maintain FCDs as an alternative to immediately exchanging the funds received into pesos.

Another initiative in improving access of Filipino households to services offered by formal financial institutions, including those residing in remote areas, focused on the customer identification requirements in line with the KYC policy applied by the covered institutions. In terms of the number of identification cards (IDs) required, the BSP has eased effectively the regulations over a span of two years — from three IDs down to one valid photo-bearing ID issued by an official authority. The term *official authority* was also expanded to include the government, its political subdivisions, government-owned and-controlled corporations (GOCCs), and private entities registered, supervised or regulated by the BSP, Securities and Exchange Commission (SEC), and Insurance Commission (IC). Policy refinements were subsequently added, with the BSP allowing the use of passports issued by foreign governments as valid IDs of OFs, who have adopted foreign citizenship and are on vacation, to engage in local financial transactions.

The main challenge to policymakers, therefore, is to provide the proper financial infrastructure and mechanisms for the migrant workers to efficiently remit their income to beneficiaries. As the remittance flow process is continually enhanced, more funds could be channeled to households' foreign exchange savings, micro-enterprise activities and other alternative financial instruments, which could ultimately lead to the achievement of the Millennium Development Goal of alleviating poverty.

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