International Labour Organization

Migrant Remittances to Armenia

the potential for savings and economic investment and financial products to attract remittances

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Prepared for ILO by Alpha Plus Consulting

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ABBREVIATIONS:

SME: Small and medium Enterprises
ADB: Asian Development Bank
USD: US Dollars
MTO: Money Transfer Organisations
RMC: Rural Migratory Coordinators
GDP: Gross Domestic Product
MSIT: Migrant Savings and Investment Trust
EU: European Union
ILO: International Labour Organisation
USAID: US AID
NGO: Non-Governmental Organisation
CBA: Central Bank of Armenia
LO: Leasing Organisations
UCO: Universal Credit Organizations
AMD: Armenian Dram
MFI: Microfinance institutions
GoA: Government of Armenia
EPC Type: Event-driven process
A&L: Assets and Liabilities

Executive Summary

Preamble

Armenian migrants make an enormous contribution to the economies of host and origin countries. The amount of remittances sent home by migrants from Armenia is estimated to exceed US$ 1.5 billion or around 18% of GDP in 2007. While the remittances sent to Armenia help the migrants' families to solve some of their financial problems, a large amount of these resources is used to cover their immediate needs. Investment in longer term sustainable economic activities is apparently limited. In 2008, ILO initiated a study which assumed conducting a survey of 1000 households that have currently a family member in migration, and a survey on financial products to attract savings and economic investments from migrants. The study aims to develop recommendations and new mechanisms for integrating remittances as an unutilized opportunity to foster economic development in the country.

The survey was carried out among 1000 migrant families to help identify the pattern of savings and investment and savings/investment potential of migrant workers and their families. The survey reveals what proportion of migrant remittances goes into savings and investment, whether this can be increased and under what conditions. The second part of the study is based on the survey of financial institutions, which aimed at the assessment of all financial products available in Armenia with the purpose of attracting the savings of labour migrants and their utilisation. It covered commercial banks and other credit organisations active in Armenia.

Having investigated the savings and investment pattern and potential of remittances and features of financial products attracting savings and economic investments from migrants as well as barriers, the final chapter provides recommendations for the design and implementation of financial products and mechanisms to leverage remittances for enhanced and long-term development impact.

Key Findings

In overwhelming majority of cases (75%), households have only one migrant family member and only in 4% of households there are three or more migrant family members. More than three quarters of the migrants are male. Over 80% of the migrants belong to the age group of 25 through 55 years old. The most popular destination for the migrants is the Russian Federation, accounting for around 73% of all migrants, with another 8% migrating to the USA and around 4% to Ukraine, thus leaving in total only about 15% to other countries. The biggest proportion of migrants abroad (around 40%) is engaged in construction as labourers.

Migrants are classified into four major groups. Almost 40% of the migrants are long-term and have stayed away from Armenia for more than two years but with several short home visits during this time. The temporary category of migrants that have only recently emigrated from Armenia currently represent the minority of the migrant population: after two years migrants in this category start showing their long term migration behaviour and start falling into one of the three major groups. Migrants who settled down in the country of destination and start losing their economic interests at home and thus basically falling out of the potential group of saving keepers or investment makers in Armenia is about one quarter. Another 20% constitute seasonal and temporary migrants staying away from Armenia for several months a year and return to Armenia for several months.

More than 70% of households in the country who have migrants abroad regularly receive remittances from them. Migrants, in general, send money back home quite frequently: 80% send money home at least once every quarter and about one fifth of households receive remittances from their family members every month. More than half of the households that have migrants abroad confirmed that the amount of remittances they receive in the current year has not significantly changed compared to the previous year. Compared to the situation some three to five years ago, when the majority of households were pessimistic about the future cash inflow from remittances, currently “pessimists” made up only less than 10%, while the overwhelming majority either forecast growth or stability of the volumes of remittances they expect from their migrants. Nearly 80% of the households spend more than 90% of the remittances received for current consumption needs, the rest is saved for providing for future consumption, future investment, future education and for special events, such as a wedding, house or apartment furnishing. A dramatically high proportion of the population (85%) reports to be able to save no proportion of his/her income. 9% of the households manage to save up to 20% of their income. However these savings are almost never kept in banks (97% of households having savings keep no portion of them in the banking sector). Almost three quarters of the households are not aware either about saving products availability or about their terms and conditions.

Main Conclusions

The deposit base of the banking sector has been constantly growing, however the cluster of the population for which remittances are the primary source of income keep their savings outside the formal financial sector thus leaving significant monetary opportunities unmet.

About half of the Armenian banks use remittance payment history in lending or attracting deposits. Some of the credit organisations practice it, but some do not use remittance payment history as a base for lending, since they consider it to be risky and they mention lack of knowledge and experience that credit organisations currently face. There are some institutions that have set a clear policy of fostering income generation within the country. That is why they do not rely too much on remittances when lending money.

For almost all banks and credit organisstions the link between savings products and remittances is indirect, i.e. while lending, remittances are considered as a secondary as opposed to primary source of income. This is because, from the banks and credit organisations point of view income justification remittances are considered to be unstable and risky

In most cases when lending money, banks and credit organisations require statements or receipts from remittance receivers to prove the remittance flows. The minimum time requirement is to provide proof for at least 6 months, though sometimes 6 months - 1 year requirement is applied. The longer the period, the better.

Among financial institutions 20-70 percent of remittance flows is considered as proof of having additional source of income. Remittances are mostly taken into consideration for small loans, consumer loans, car loans, mortgages etc., but not for corporate loans.

Besides remittance-backed lending there are also remittance-backed deposits, which are not very popular among remittance receivers. They say that the money they receive is for current consumption, not for saving. Mainly small amounts for current consumption or targeted expenses flow through MTOs (Money Transfer Organisations).

The idea of improving existing remittance-backed financial products did not seem to be very much approved by the Armenian bankers. They think that currently there is not too much potential for improvement of existing schemes and making them more efficient. Clients already borrow; there is enough demand for loan products. Besides, most of the money is for current consumption, and even if a certain portion is for savings or investments, the purpose is decided in advance (e.g. for buying a house, investing in a business). After investing the money, something is rarely left to be deposited in the banks. However, as the survey shows there is a big potential (more than 100 million USD) – in remittances that are saved for special events, tuition and health care, and this money can be attracted to the financial system. As concerning lending products, new remittance backed schemes or simplifying proof of income requirements can be risky according to the financial institutions. During the interviews they were mainly reluctant to think of other innovatory schemes that could attract more borrowers (such as the product proposed in this study, related to health care).

Credit organisations seem to be more flexible on this issue: remittance-backed products can be improved when clients realise that they can borrow under more favourable conditions from lending organisations than from banks. If legislation allowed lending organisations to attract deposits (with some limits) or if savings accumulation mechanisms were applied successfully then more efficient remittance-backed schemes could be developed.
In general, the financial institutions face a lack of specialists who know international best practices and can develop efficient remittance-backed products.

However, the unanimously acknowledged main potential is that annually more than USD1 billion flows to Armenia in the form of migrant remittances, and this tendency is more likely to continue in the near future, given that the level of unemployment is still rather high and there are scarce opportunities for doing business in the country. In rural areas there is more potential, as rural population is more dependent on remittances.

There are several barriers to developing remittance-backed-products: population mentality, technical problems with income justification, legislation, lack of skilled specialists, lack of motivation, risks related to instability of remittance flows, predetermined nature of remittances.

There are also risks related to remittance-backed products: instability of flows, realisation of collateral, risks related to control (fake transfer, or statements), risks of non-repayment, currency fluctuation risk.

Opinions on the future development of remittance-backed schemes can be divided into two main groups: a) these schemes have a future in Armenia, since more than 1 billion USD flows into Armenia. And this tendency seems to continue in the nearest future, since the level of unemployment is still high and opportunities for doing business are still limited; b) on a macro level these schemes will remain at the same level of development but, on a micro level, share of remittance-backed products will decrease: as remittance receivers take loans and become more self-sufficient and independent from remittances.

In general, strategic planning is made based on residence, by legal status, currency, duration but not by source of income (remittances or income generated in the country).

Remittances are not considered to be a primary source of income for potential borrowers of small loans, despite the fact that the overwhelming part of the remittance flow is executed through Money Transfer Organisations (MTOs) and could be easily tracked.

Recommendations and Proposed Mechanisms

Recommendations based on the key findings and conclusions of the study are twofold:

A. Recommendations related to revitalisation and activation of underdeveloped **existing** schemes and products currently practiced by the financial sector in Armenia and,
B. Recommendations in the form of newly designed innovative mechanisms that would help use the remittances as a serious financial back-up for projects substantially affecting different aspects of economic developments.

The newly proposed mechanisms to integrate remittances aim at tackling the revealed gaps and taking advantage of the available opportunities of attracting remitted amounts into the financial system.

The principles for the development of new mechanisms stipulate that these mechanisms are: i) financially viable for the institution that is going to apply it, ii) directly linked to the economic development in Armenia (not products just designed for migrants, but must be targeted: link migrant remittances with the economic development), iii) innovative for Armenia, iv) treating remittances as a *primary* source of income as opposed to treating them as a secondary source, like it is currently done and v) based on a clear recognition that remittances are private transfers and that the savings involved belong to migrants and their families, whose primacy choice in their allocation is paramount.

Mechanism 1. Establishing Migrants Savings and Remittances Trust
This is a proposed vehicle of attracting migrants' savings to re-invest in their home communities through offering guaranteed deposit or/and project co-ownership opportunities in line with the various needs, priorities and objectives of the migrants themselves.

Mechanism 2. Using Remittances to Convert Non-Bankable Micro entrepreneurs into Eligible Borrowers
The mechanism will enable so far ineligible-for-borrowing rural micro entrepreneurs to get credit by using the existing financial arrangements and frameworks, leveraging on the remittances that come in constantly that are

mainly for consumption purposes and are not used by the financial sector. It stipulates the establishment of a system of using regularly received remittances as a loan guarantee as well as a primary source for repayment. It also contributes to an increase of institutional and programmatic cost-effectiveness and reduces the credit risk of lending to a remittance receiving client base.

Mechanism 3. Facilitating Organisation of Family Events

This is going to be a new deposit product helping remittance receivers to organise events like weddings and to help them hedging against changing prices.

Mechanism 4. Making Tuition Fee Requirements More Accessible

This is going to be a new deposit–loan mixed product enabling remittance receivers to pay tuition fees for their children by borrowing loans guaranteed by remittances.

Mechanism 5. Expanding Medical Insurance Coverage

A client cannot afford to make a lump sum payment in order to buy medical insurance.

The bank or the credit organisation buys insurance policy for the client and registers this transaction as a loan. The client, who is a remittance receiver, pays off this loan using migrant remittances.

INTRODUCTION

Migrant remittances constitute an important source of foreign exchange, enabling countries to acquire vital imports or pay off external debts and also play an important role in reducing poverty. There is growing awareness of the potential that remittances have to contribute to economic development in migrant-sending countries at the local, regional and national levels. Given that remittances are private funds, measures to enhance their development impact should however not be involuntary in nature for the senders and recipients[1].

Armenian migrants make an enormous contribution to the economies of host and origin countries. The amount of remittances sent home by migrants from Armenia through official channels was over US$ 1 billion or 19% of GDP in 2006 (World Bank). The remittances sent to Armenia help the migrants' families to solve some of their financial problems, and a large amount of these resources is used to cover their immediate needs. Investment in longer term sustainable economic activities is apparently limited.

While remittances to Armenia have been studied in research commissioned by USAID and the Asian Development Bank (ADB) the focus and content of this study initiated by the ILO breaks new ground.

The study comprises the following chapters:

1. Survey of remittance-backed savings and economic investments by migrants and families of migrants

A survey was carried out among migrant families to help identify the pattern of savings and investment and savings/investment potential of migrant workers and their families. The survey indicates what proportion of migrant remittances goes into savings and investment, whether this can be increased and under what conditions.

[1] Source: Handbook on Establishing Effective Labour Migration Polices in Countries of Origin and Destination. P 77

2. Survey on financial products to attract savings and economic investments from migrants

An assessment of all financial products available in Armenia with the purpose of attracting savings of labour migrants and their utilisation was made. It includes commercial banks, micro-credit and community based funds. Barriers to their popular use were also appraised.

3. Design of financial products and mechanisms to leverage remittances for enhanced development impact

Having investigated the savings, investment pattern and potential of remittances and features of financial products attracting savings and economic investments from migrants, as well as barriers, this chapter provides recommendations for the design and implementation of financial products and mechanisms to leverage remittances for enhanced and long-term development impact.

HOUSEHOLD SURVEY: REMITTANCE-BACKED SAVINGS AND ECONOMIC INVESTMENTS

SURVEY SCOPE

The household survey covers the following topics:

- Profile of Migrants, including number of migrants abroad in each household, distribution of migrants by sex, age, geography, and occupation
- Migrant groups
- Remittance behaviour
- Fact of receiving remittances by geography, status in migration, and by senders in relation to household head
- Frequency of receiving remittances
- Change of remittances compared to previous year, and forecast for next year
- Use of remittances, change in use of remittances in past years
- Use with frequency of receiving
- Change in use in next years
- Savings behaviour
- Having an active bank account
- Portion of income saved, portion of savings kept in banks
- Reasons for not keeping savings in banks
- Objectives for savings
- Awareness of available savings schemes in general and by age
- Savings of migrants abroad and their intension to return home
- Engagement of respondents in business, sector of engagement

METHODOLOGY

Sampling and Distribution

The survey was conducted in all regions (Marzes) of Armenia based on geographic, economic development and migration diversities. The total number of respondents was 1000. While Yerevan took up about 40% of the total respondents, the rest of the respondents were distributed among all other Marzes. The division between the urban and rural areas, as well as the distribution of respondents by specific communities was based on the population statistics, as shown in the table below:

Gegharkunik region	Population			Distribution of respondents (urban vs. rural)	
	Urban	Rural	Share in sub-total (urban vs. rural)	Urban	Rural
TOTAL in Marz	**70,858**	**144,513**		**49**	**99**
Towns					0
Gavar	23,302		33%	**16**	
Chambarak	6,198		9%	**5**	
Martuni	11,117		16%	**8**	
Sevan	18,776		26%	**12**	
Vardenis	11,465		16%	**8**	
Villages					
Ddmashen		2,173	1.5%		**5**
Tsovagyugh		3,885	2.7%		**5**
Lchashen		4,212	2.9%		**6**
Norashen		440	0.3%		**5**
[illegible]		5,465	3.8%		**7**

based on population proportions among Marzes

While the villages to visit for interviews were selected on a random basis from the list of all villages in each Marz, the approaches to the respondent households were organised on a systematic pick-up basis, starting from the village centre towards a certain direction. The positive answers to questions “do you have a family member migrant abroad?” and “if yes, would you agree to answer a few questions?” served as a basis to interview respondents.

Number and Qualification of Surveyors

Five groups of surveyors worked concurrently to survey the entire target group. Each group consisted of two persons – *Lead surveyor* and *Assistant* numerator. The Lead surveyors, selected mainly based on their strong communication skills, were *introducing* the team, *explaining* the survey purposes, and *asking* the questions. The Assistants were responsible for *filling in* the questionnaires having specifically been trained in that. This is a proven effective practice, which allows for i) spending time for interviews more efficiently, ii) eliminating technical mistakes, and, most importantly, iii) making the respondents feel more comfortable in being the object of the interviews, considering the fact that sensitive questions were posed about the income levels, earnings and savings.

RESPONDENT PROFILE

The target respondents were households who currently had at least one member of their family in migration.

Figure 1. Gender distribution of respondents

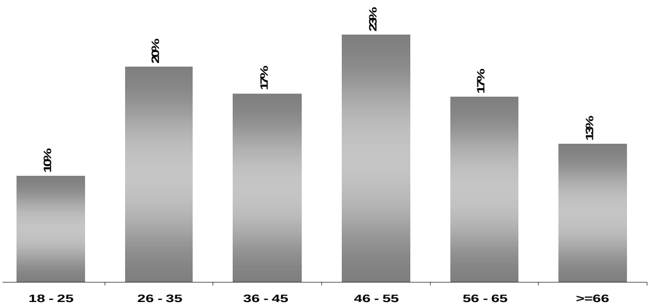


Figure 2. Age distribution of respondents

An initial look at the respondent profile suggests that three quarters of the respondents belonged to the age range of 26 through 65 years old.

Females represented the majority of the sample primarily because, at the time of visits for personal interviews, many potential male respondents were at work or in migration.

Figure 3. Geographical distribution of respondents

As the sampling was based on the general population residence geographic distribution, the map representing the geographic distribution of the respondents matches the general population distribution pattern. According to it, Yerevan covered nearly 40% of the respondents, as can be seen in the map below.

PROFILE OF MIGRANTS

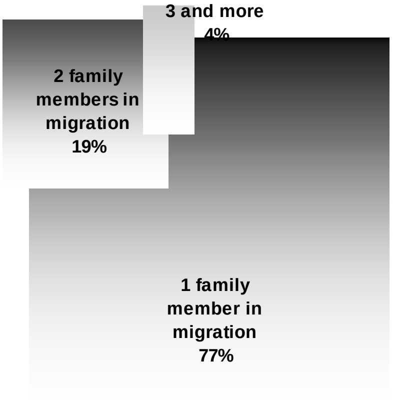


Figure 4. Family members in migration

Number of Family Members in Migration

The overwhelming majority of households have only one family member in migration (the survey was conducted in March-April 2008) and only 4% of households have three or more family members in migration. These results are very similar to those provided in "A Study on International Migrants' Remittances in Central Asia and South Caucasus"/Country report on Remittances of International Migrants and Poverty in Armenia/ADB. This is natural due to various reasons, but it is also valuable from the analytical viewpoint, since the questions in the *remittances* section refer to the main migrant, which would allow for a more accurate representation and extrapolation of the results.

Migrants General Characteristics

The distribution of migrant by sex, age, migration destinations and occupation is presented in this section. Distribution of migrants by sex is illustrated by the pie chart, according to which more than three quarters of the migrants are male. This has been a traditional sex distribution pattern for the Armenian migration starting even from the Soviet times and up to the present. Males have traditionally had the role of the bread winner and thus migrated more frequently.

Figure 5. Gender distribution of migrants

Over 80% of the migrants belong to the age group of 25 through 55 years old, with the younger segment (26 – 35) having a relatively greater share (30% of total). Naturally, after the age of 55 years the migration drops.

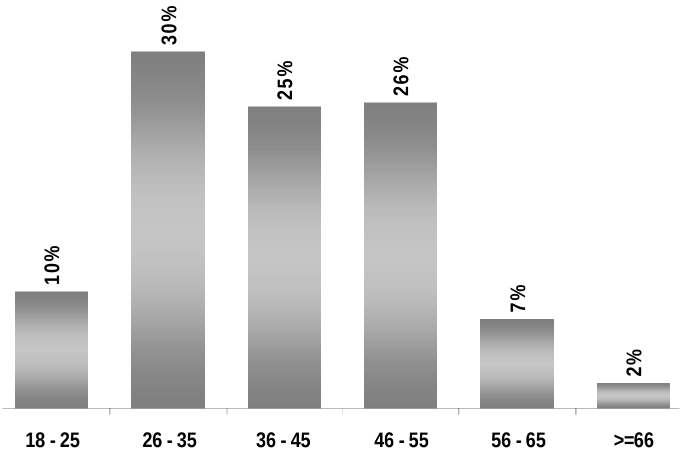


Figure 6. Age distribution of Migrants

Table 1. Geographic distribution of migrants

Russia	**73.1%**
USA	**7.9%**
Ukraine	**4.4%**
Other countries	**4.0%**
Germany	**2.7%**
France	**1.6%**
Greece	**1.1%**
Kazakhstan	**1.1%**
Spain	**1.1%**
Georgia	**0.9%**
Belgium	**0.8%**
Turkey	**0.5%**
Belarus	**0.5%**
Netherlands	**0.4%**

The most popular destination for the migrants identified through the household survey was the Russian Federation, (this is confirmed by ADB report), accounting for around 73% of all migrants, with another 8% migrating to the USA and around 4% to Ukraine, thus leaving in total only about 15% to other countries, which indicates the highly concentrated nature of migration by destinations. The popularity of Russia as a destination was strongest among migrants from Lori, and Ukraine, in relative terms, for migrants from Gegharkunik. As the international experience suggests, labour markets need both skilled and lower skilled workers. While most destination countries compete for highly skilled labour, many host societies are hesitant about admitting lower skilled workers. Nevertheless, as in case of Russia –the main destination for the Armenian migrants - there are frequently acute shortages of labour in lower skilled sectors in some countries, given that these are jobs that nationals are reluctant to take[2].

[2] Source: Handbook on Establishing Effective Labour Migration Polices in Countries of Origin and Destination. P 19

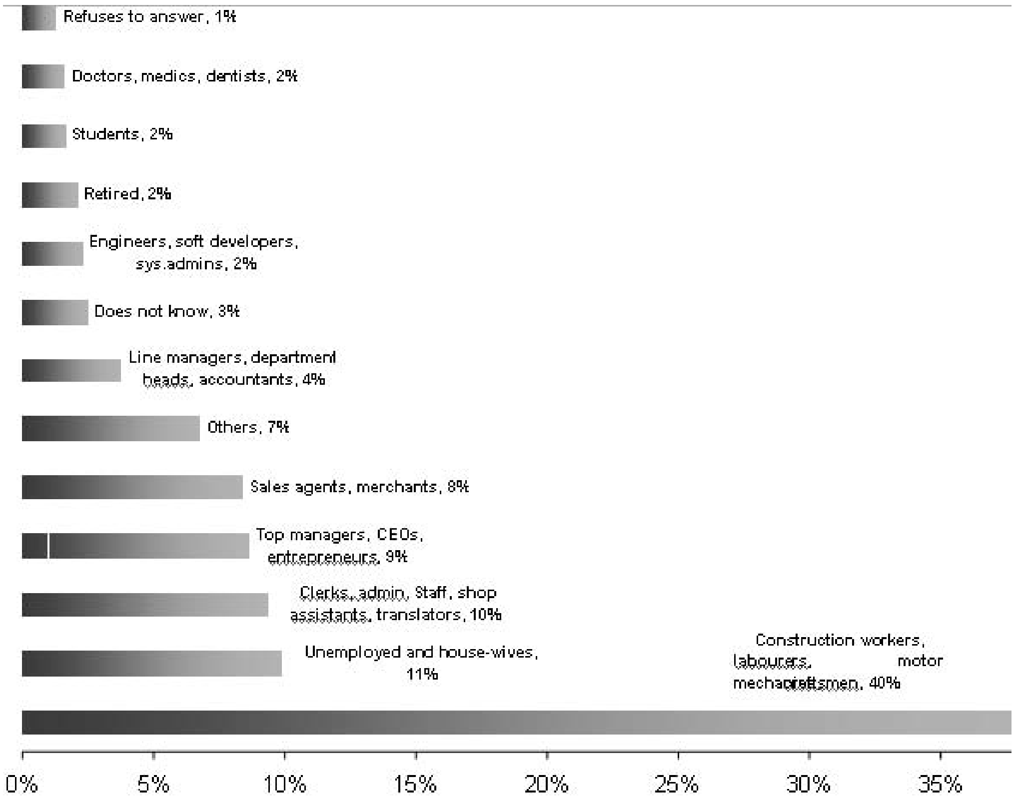


Figure 7. Migrants by occupation

As illustrated in the bar chart, the biggest proportion of migrants abroad (around 40%) are engaged in construction as labourers. This category also includes motor mechanics, craftsmen etc. This means that the flow of remittances is not only in direct correlation with the general economic growth and increased income in the destination countries, but, given the high concentration by industry of engagement, is more dependent on the construction and automobile sectors growth.

Migrant Groups

General picture

Four principal migrant groups have been identified among migrants that reflect different patterns of migration:

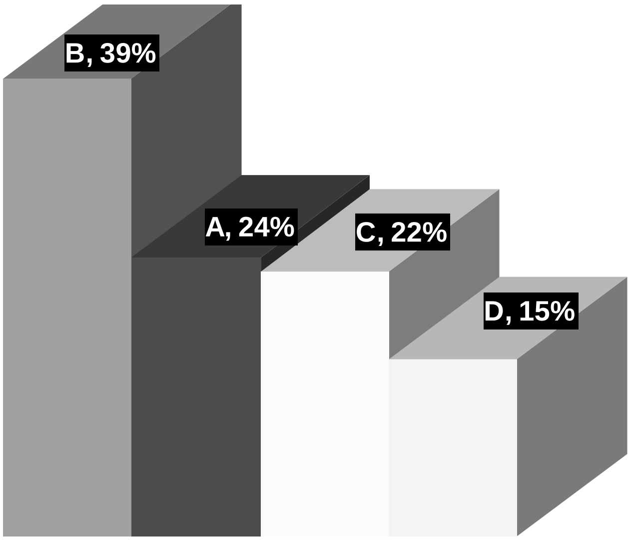


Figure 8. Distribution of migrant categories / groups

A. Long-term migrants that have been away from Armenia for more than two years with no home visits during this time

B. Long-term migrants that have been away from Armenia for more than two years but with several short home visits during this time

C. Short-term migrants: living outside of Armenia for several months a year and returning to Armenia for several months

D. Recently (less than 2 years ago) migrated from Armenia

These four categories represent complementary groups of migrants and, once the migrant is categorised correctly, the groups do not overlap and should represent 100% of the migrant population. According to the collected statistics, almost 40% of the migrants are long-term migrants, and have been away from Armenia for more than two years but with several short home visits during this time. Category D currently representing the minority of the migrant population is a temporary one: after two years migrants in this category start showing their long term migration behaviour and start falling into one of the three groups above. As the picture demonstrates, category A migrants, i.e. those who settled down in the country of destination and start losing their economic interests at home and thus basically falling out of the potential group of saving keepers or investment makers in Armenia is about one quarter. Category B – the largest community of migrants – remains in the "risk group" of people who may potentially lose their economic interests at home and serves as a feeding source for category A – non-returning migrants.

Migrant Groups by Destinations

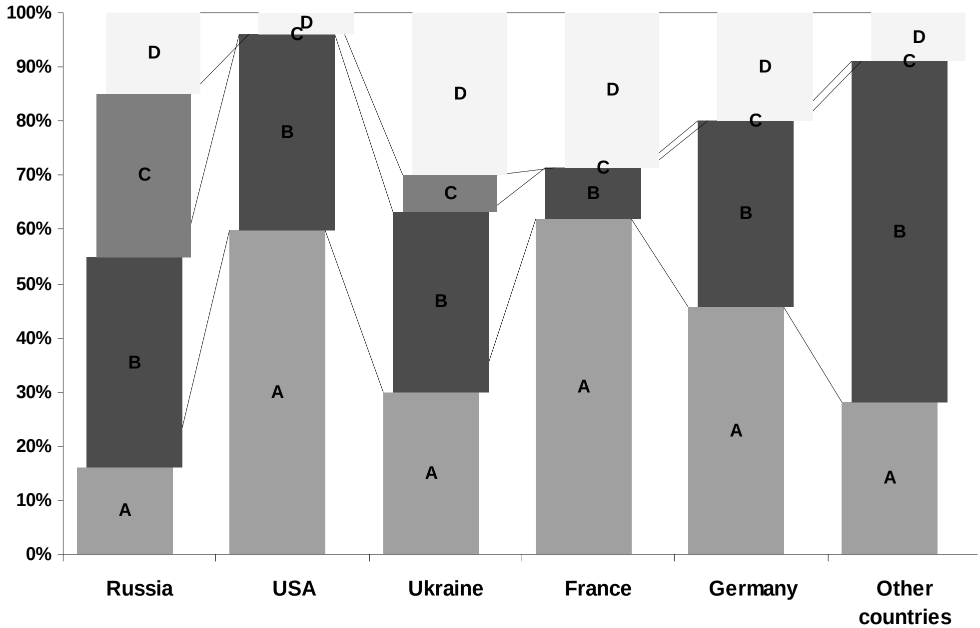


Figure 9. Migrant groups by destination

It is extremely interesting to see the breakdown of categories by countries of destination. Before analysing the picture, a little reservation should be made on the statistics of countries other than Russia, Ukraine and USA. The real picture for those countries could be somewhat different given a tiny proportion of respondents from those countries in the sample. Nevertheless, it is clear that there are practically no category "C" migrants in countries outside Russia and Ukraine. Indeed, the absence of visa regime, regular flights and mostly the absence of a language barrier makes those destinations relatively attractive for shorter term seasonal visits. USA, Germany and France – the farthest destinations are leaders of being nests for non-returning migrants.

REMITTANCE BEHAVIOUR

Though macroeconomists define migrant remittances[3] as personal monetary transfers, migrant remittances can be defined more broadly as monetary transfers that a migrant makes to the country of origin or, in other words, financial flows associated with migration.[4]

Fact of Receiving Remittances

General picture

Figure 10. Fact of receiving remittances

As the pie chart suggests, more than 70% of households in the country have migrants abroad and regularly receive remittances from them. Normally, there is a certain percentage of people who hide the fact of remittance receiving "just in case" (fear of individuals to declare remittances for tax or status reasons). So the real number of remittance recipients is believed to be even higher than 71%.

The two cornerstones of the migration experience are i) achieving sufficient income to allow for both the ability to remit, on the remitter's side and ii) the ability to save, on the recipient' side. An analysis of the household survey results found that the propensity to remit was higher among men and married people. The likelihood to remit increased with age as well. The likelihood to send money home was strongest among seasonal – category C – migrants. Similarly with the results presented in the ADB report on Armenia the likelihood of sending remittances decreased as the period of separation increased and direct contact with families at home decreased. Obviously, many of the long-term migrants migrated along with their immediate family, thereby reducing the need to send money to Armenia.

[3] Generically, remittances encompass a range of funds transfers, including profit remittances of multinational corporations, school fee payments and remittances by individuals.
[4] Source: Handbook on Establishing Effective Labour Migration Polices in Countries of Origin and Destination. P 71

Receiving remittances by geography

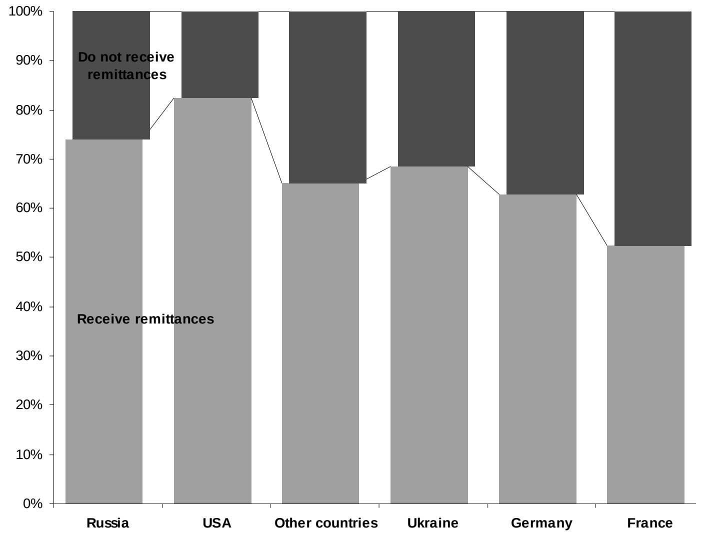


Figure 11. Receiving remittances by geography

The bar chart on the left illustrates the breakdown of the fact of receiving remittances by destination countries. As can be observed, migrants in USA and Russia are more inclined to send remittances than those in other countries regardless of the status of migration although the discrepancy is sometimes quite deep: from 83% in the USA down to 55% in France. In the ADB report the lead countries are the same, where USA was the second largest "remittance –generating" country.

Receiving remittances by status of migration

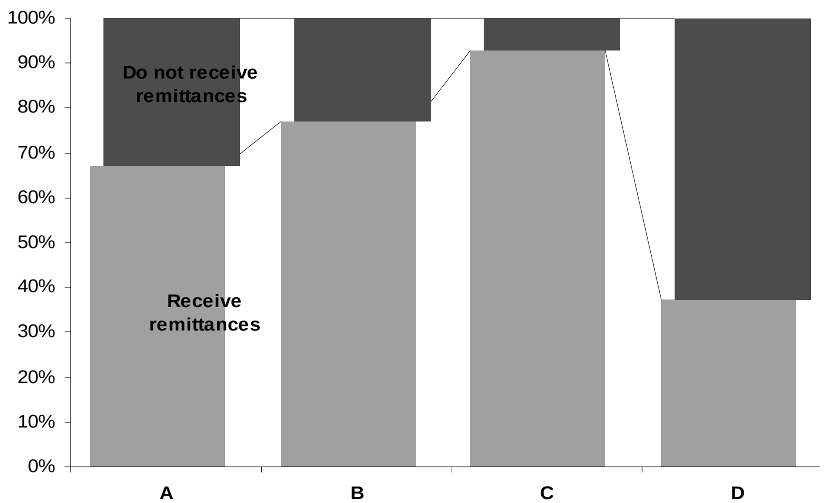


Figure 12. Receiving remittances by status of migration / migrant categories

Status of migration, as can be observed in the picture on the right side, strongly influences the fact of remitting. Obviously, a short term migrants' primary objective is to earn money and bring/send the money back home; that is why more than 90% of category C migrant households receive remittances (including cases when the cash is physically brought back after the seasonal migration). Even more natural is the fact that only one third of people, who migrated only recently and their status and plans are still uncertain, send money home. During the first months and years of migration, they try to stabilise their income and to pay back debts incurred to migrate; after that period they usually start sending remittances on a regular basis.

By senders in relation to Household head

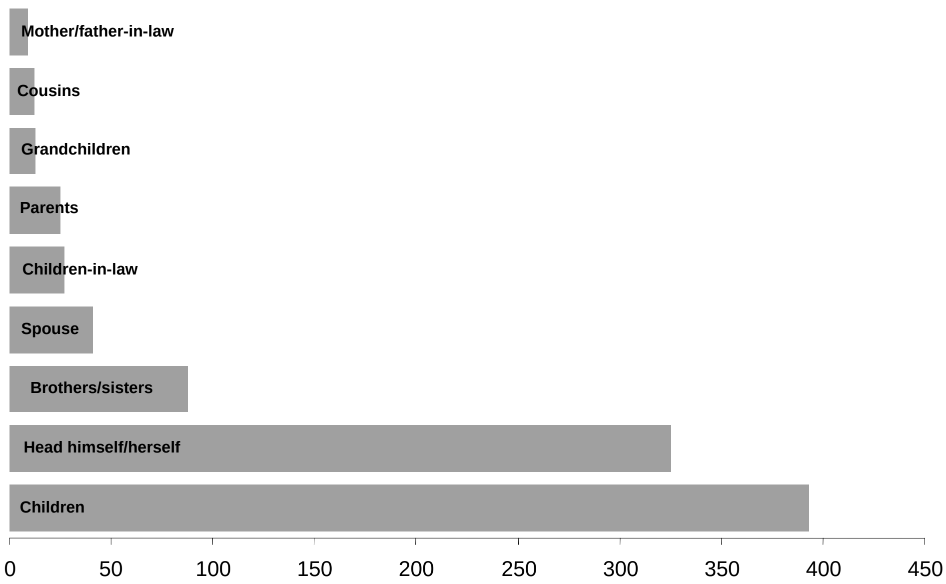


Figure 13. Receiving remittances by senders in relation to HH head

The household head was set to be the "anchor" person for the questions related to family relationship and was not necessarily the person with whom the interview was conducted. That is why we witness the head of the households themselves to be one of the two main categories, along with the children, to be most "committed" to send money back home.

Frequency of Receiving

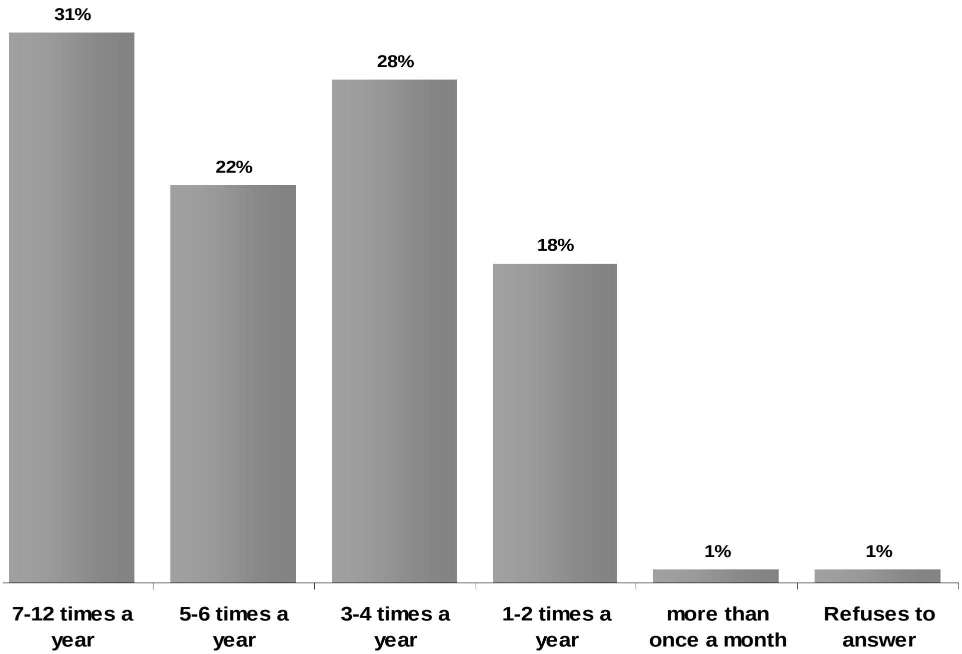


Figure 14. Frequency of receiving remittances

As illustrated in the bar chart above, migrants, in general, send money back home quite frequently: 80% send money home at least once every quarter and about one fifth of households receive remittances from their family members every month (these figures are comparable with the results presented in ADB report according to which about 57% of senders were sending remittances at least twice a year). This is related to the regularity of the income migrants receive in the destination countries, the size of that income, and the consumption needs of the family back home, which makes it easier to make transfers in smaller quantities but more regularly.

Change of Remittances Compared to Previous Year

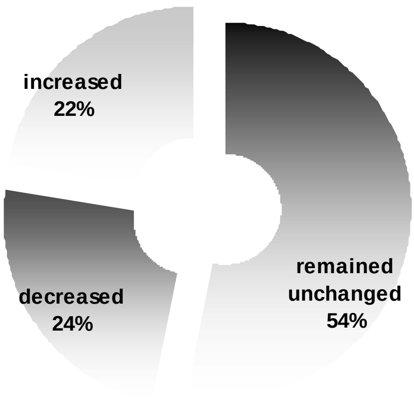
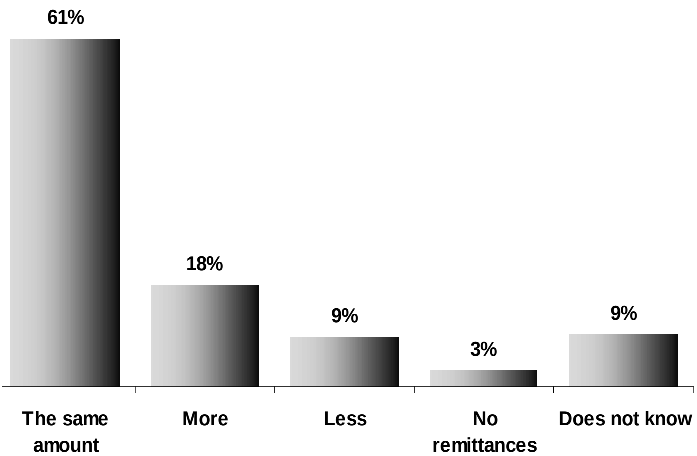


Figure 15. Change of remittances compared to previous year

More than half of the households that have migrants abroad confirmed that the amount of remittances they receive in the current year has not significantly changed compared to the previous year. The shares of those who reported an increase and decrease in the amounts are almost equal to each other. This is in contrast with the official statistics of the remittance flow, which estimated a 10-15% growth. The reasons may lie in possible misreporting of the respondents as well as due to the growth of the migrant population in absolute terms, but also in the fact that the statistics account for the foreign currency remitted and the respondents tend to indicate the amount of income in the local currency, in which all spending is made. Due to the appreciation of the Dram, increased amounts in US dollar, for example, could be well classified under “remained unchanged”.

Forecast for Next Year



–Figure 16. Forecast for change of remittances next year

Possibly due to the extremely tense and unpredictable political situation in the country[5] during the time when interviews were conducted, people were cautious more than usual forecasting the amount of remittances not to change over the next twelve-month period

[5] Mass demonstrations, questionable results of presidential elections in 2008, and, as a result, tense political situation.

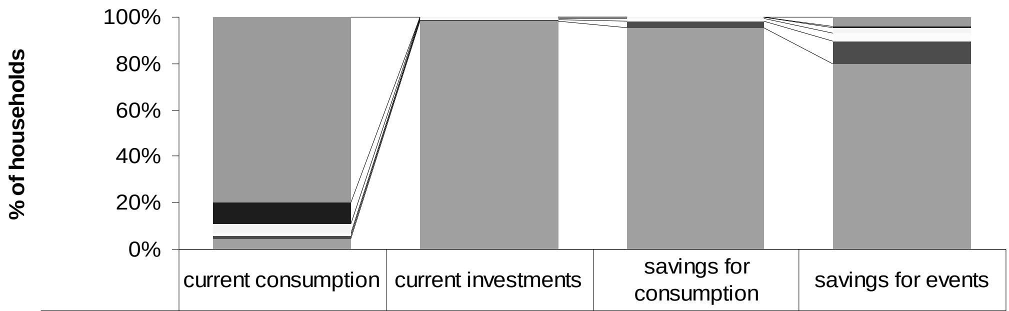
(61%). Compared to the situation some three or five years ago, when the majority of households were pessimistic about the future cash inflow from remittances, there is now less than 10% of pessimists, which is a direct result of the recent clearly positive trend in the actual flow of remittances into the country, quite evenly distributed among the type of migrants and the industries they are involved in (primarily because of the more or less even distribution of the national income rise in Russia). One fifth of the households is not afraid to predict an increase in their remittances. Again, this is primarily based on the recent trends interpretation rather than clear information from the remittance senders that they would be sending more.

Use of Remittances (Directions)

The directions for use of remittances were conditionally divided into four main groups:

- current consumption (food, clothes, transport, current education fees, current debt repayment, etc)
- current investment in business
- savings to provide for future consumption, future investment, future education and
- savings for special events, such as a wedding, furnish house or apartment

% of remittances spent in four directions



	current consumption	current investments	savings for consumption	savings for events
81-100%	80%	0%	0%	4%
61-80%	9%	0%	0%	1%
41-60%	4%	0%	0%	2%
21-40%	1%	1%	2%	3%
< 20%	1%	1%	3%	9%
No portion	4%	98%	96%	80%

Figure 17. Use of remittances

The table and the graph above illustrate the distribution of the remittances by the directions of their use. It can be observed that 80% of the respondents spend 80% to 100 % of the remittances received for current consumption needs (similarly, the ADB report stated/confirmed that overwhelming majority of HHs used remittances for everyday basic needs). 98% of households spend practically no proportion of remittances on current investments, but the seemingly small amounts spent on saving for future consumption and savings for future events (e.g. about 6% of households save at least half of the remittances received for future events) create a huge unmet opportunity for introducing new financial mechanisms to leverage the funds that otherwise remain "under the mattress" before they are spent. Admittedly though, very little can be done with the majority of transferred amounts, because these amounts are cashed and consumed immediately.

Applying the weighted average method, one can estimate that *on average 82% of remittances is spent on current consumption needs, and about 8% of remittances is saved for various reasons (of which about 7% for special events).*

Use cross-tabulated with frequency of receiving

The picture on the right gives an idea about the relationship of remittance receiving frequency and the direction of the remittance used as far as spending on current consumption is concerned.

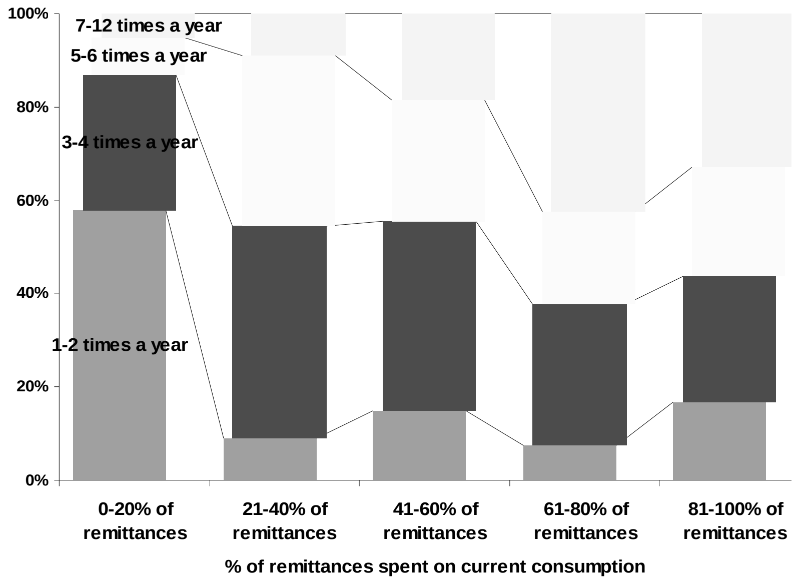


Figure 18. Remittances spent on current consumption by frequency of receiving

The picture shows that the more frequently migrants send money home the greater the inclination is that this money will be mostly or entirely spent on consumption.

Change in Use of Remittances

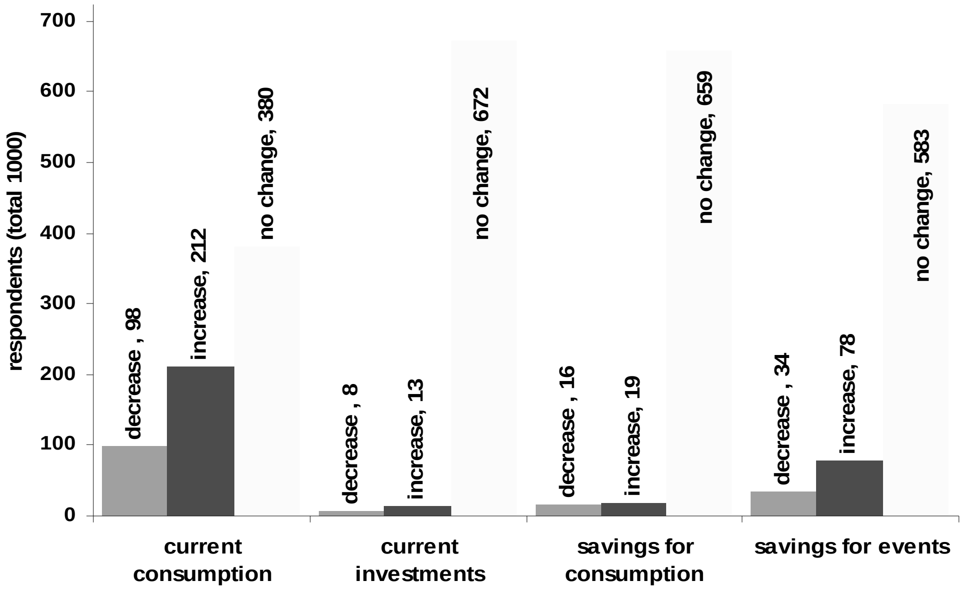


Figure 19. Change in use of remittances

The question was asked about the ABSOLUTE CHANGE in remittances spent in various directions (increase or decrease) as opposed to the change in proportions. It is now clear that the pattern more or less matches the general change in remittance volumes picture. Here again the majority indicates no change, however proportionately the remittances used for current consumption have increased to a greater extent.

Expected Change in Use in Next 2 years

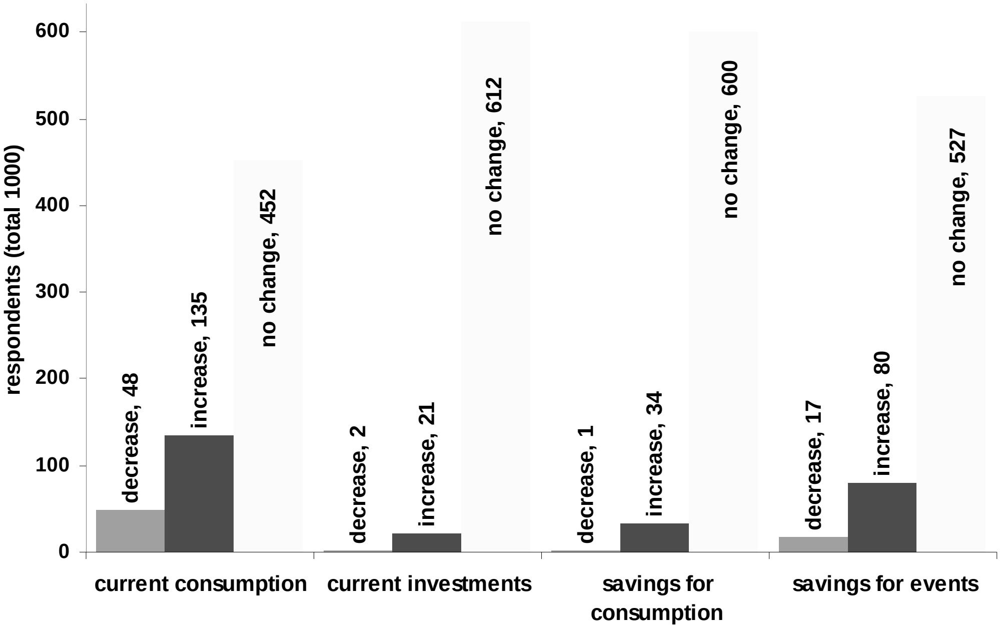


Figure 20. Expected change in use of remittances

Again, the question was asked about the ABSOLUTE CHANGE (increase or decrease) as opposed to the change in proportions. Here we see that more people believe that they would start or continue saving, though the recent spike in consumer prices in the first two quarters of 2008 made a significant number of households forecast an increase in current consumption, too.

SAVINGS BEHAVIOUR

Having an Active Bank Account

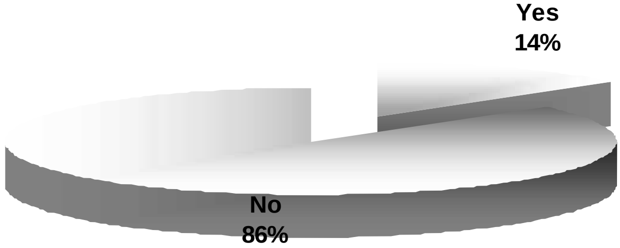


Figure 21. Having an active bank account

Before asking about the savings behaviour of the respondents and their household, it was checked if the respondents had a bank account – at least for current transaction purposes, which would be the first prerequisite for the person to save some portions of his/her income in the financial sector. Unfortunately, but quite expectedly, only 14% of the respondents reported to have an active bank account. Again quite expectedly, this proportion is much greater in Yerevan vs. the Marzes: in rural and other than Yerevan urban communities not even every tenth adult inhabitant has an active bank account, whereas in Yerevan almost every fourth does (see diagram below).

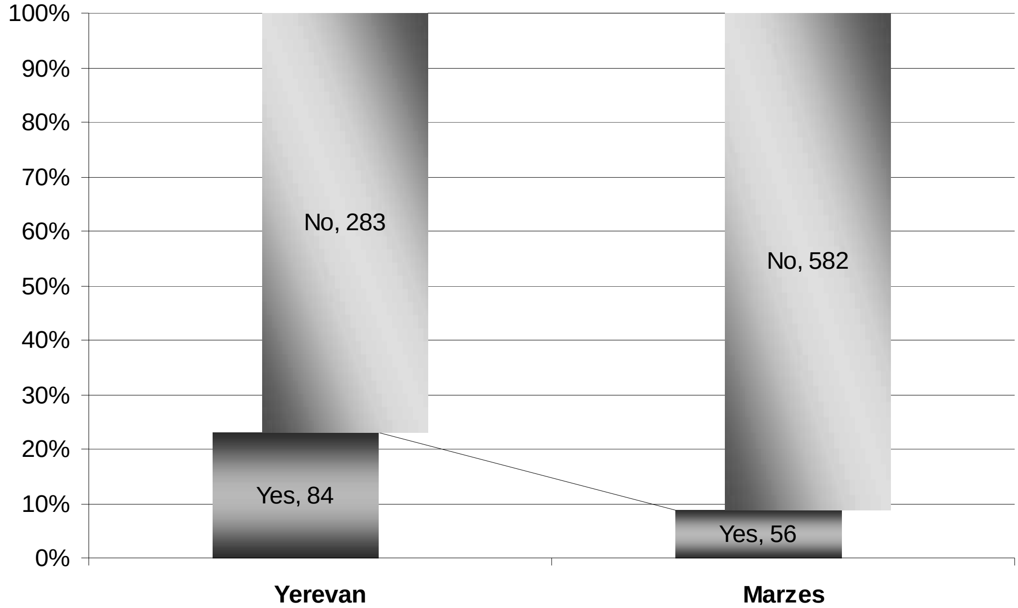


Figure 22. Having an active bank account by Marz

It is interesting to note that for both remittance receivers and non-receivers the proportion of having versus not having a bank account is exactly the same: 14% vs. 86%.

Portion of Income Saved

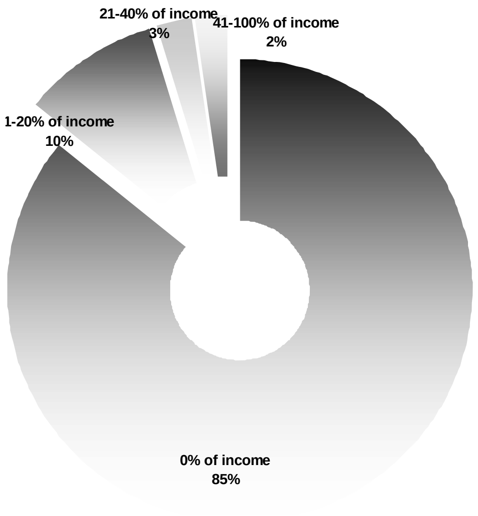


Figure 23. Portion of total income saved

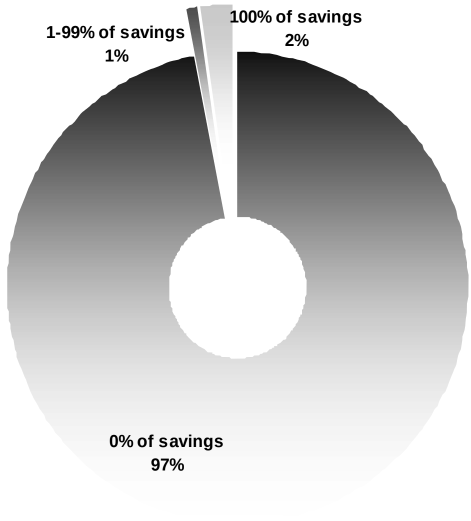


Figure 24. Portion of savings kept in banks

The pie chart on the left above gives the breakdown of the proportion of the households' total income (obviously, many of them have income other than remittances – pension, low level salary, etc.) that is saved. A dramatically high proportion of the population (85%) reports to be able to save no proportion of his/her income. 10% of the households manage to save up to 20% of their income (they report so, but in reality it may be even higher). However, as we see on the pie chart on the right hand, these savings are almost never kept in the banks (97% of households who have savings keep no portion of them in the banking sector).

Reasons for Not Keeping Savings in Banks

While this gives an opportunity for saving products to be linked to remittances, it is nevertheless interesting what the reasons are for keeping the savings anywhere else but the bank.

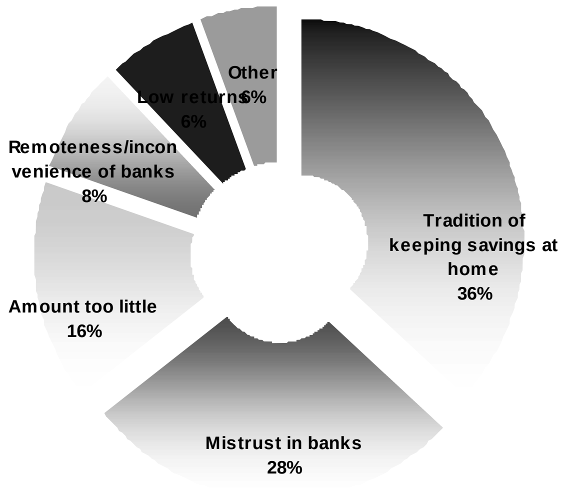


Figure 25. Reasons for not keeping savings in banks

One can observe from the pie chart on the left that the reasons are quite diverse and they are not necessarily complementary, but more than one reason could be mentioned: this is a cumulative picture. Mostly, people admit that they are quite conservative in changing their habits and that keeping money at home has been traditionally what they have been always doing. Mistrust in banks is the second popular answer with around 30% of respondents mentioning that. Studies[6] suggest that along with the introduction of the deposit guarantee system and stricter policy of the Central Bank of Armenia the mistrust in banks will yield its position to the currently unpopular reasons, such as remoteness or inconvenience of the bank branch locations, low returns for the deposits placed with the banks, etc.

[6] KfW study on awareness of the deposit

Objectives for Saving

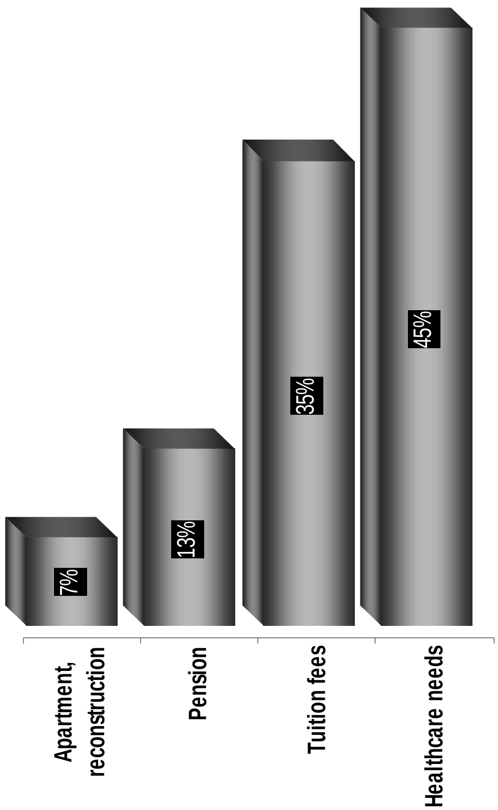


Figure 26. Objectives of saving

Most popular response

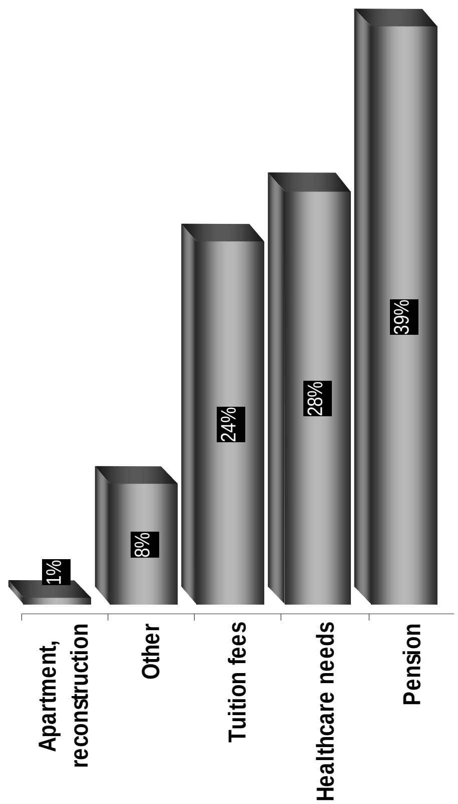


Figure 27. Objectives of saving

Cumulative responses

This is one of the most important and critical findings of the survey – revealing the primary objectives for people to save money – no matter where – instead of current consumption. Healthcare needs is the most popular response (mentioned as the first, “top of mind” response), which means that the issue is really critical to the Armenian households. Along with children tuition fees, these reasons served a basis to suggest products and mechanisms to integrate the needs and the unmet opportunities. Spending on education and health care needs are also claimed to be important according to the ADB study results. The very low rate of savings for housing is interesting, as usually housing represents a big proportion of the use of remittances. Probably, this is because the way the question was asked suggested a more stretched perspective of saving objectives, as opposed to immediate distribution of savings referred to in section *Use of remittances.*

Awareness of Available Savings Schemes

Figure 28. Awareness of available savings schemes

But are people aware about the schemes that are currently offered by the financial sector? The survey revealed that they are not – almost three quarters of the households are not aware either about saving products availability or about their terms and conditions. This leads to the conclusion that before introducing new mechanisms and schemes, the financial sector has a lot to do with regards to the awareness raising and attraction of new clients to become depositors.

Awareness across age groups

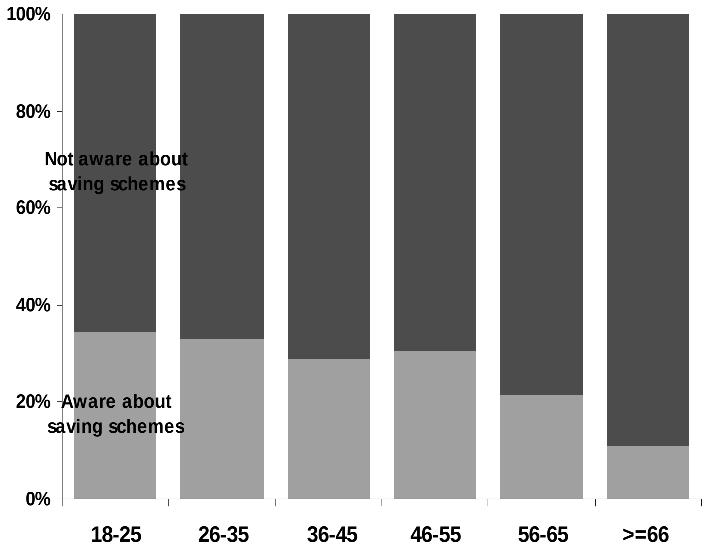


Figure 29. Awareness of existing savings schemes across age groups

Quite expectedly, there is a strong correlation between the age groups and the awareness – the younger generation is much more aware about the available products than the older generation, which of course does not mean that younger people save more; this is only about the awareness.

Awareness in Correlation with Bank Account

Certainly, the awareness about the saving products is much greater with those people who currently have an active bank account. Though it is not necessary that all of them specifically have deposit accounts, the awareness is still quite high (more than 60%)

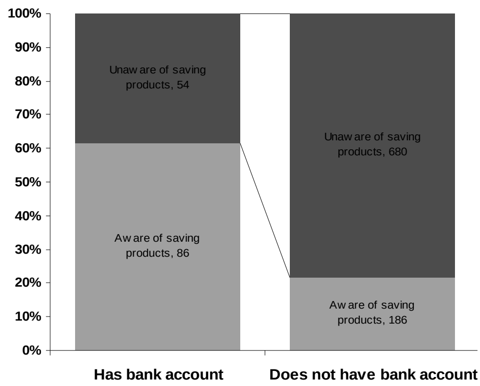


Figure 30. Awareness of existing savings schemes in correlation with having a bank account

ENGAGEMENT IN BUSINESS

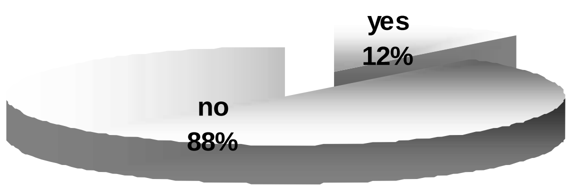


Figure 31. Fact of engagement in business

Only 12% of households (*bearing in mind that they represent not the total population but only households having migrant family members abroad*) are engaged in any kind of business activity in Armenia.

Engagement in Business Activity

Industry-wise, mainly it is commerce at a micro level (small shops, selling groceries by the village road etc, 43%) and agricultural business activity (plant growing and cattle breeding, 33% in total).

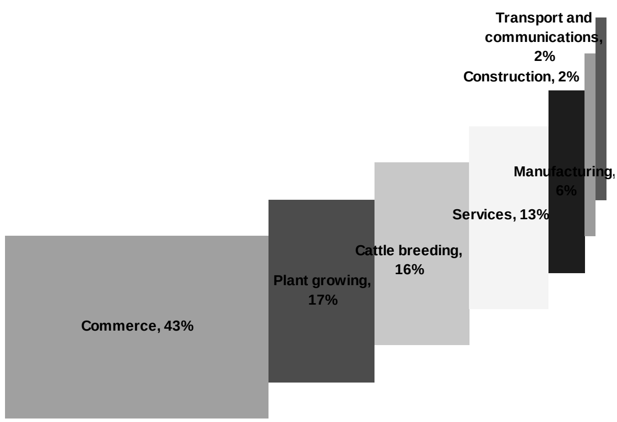


Figure 32. Engagement in business by sector

FINANCIAL SECTOR: MIGRANT AND REMITTANCE PERSPECTIVE

BACKGROUND INFORMATION

Armenia: Banking Sector Overview

After the collapse of the Soviet Union, Armenia experienced two major shocks related to the banking system. The first shock was the drastic depreciation of the Soviet rouble in early 1990s and, as a consequence, the complete erosion of people's savings in the Savings Bank by 1993, when the Armenian Dram was introduced. Meanwhile, a large number of small undercapitalised commercial banks sprung up in Armenia within a short time in the early 1990s. The number of banks increased from only six banks (five state-owned banks and one commercial bank) in the beginning of 1991 to 74 by the end of 1993, most of them being "pocket" banks owned by large state enterprises and some "new capitalists". In the absence of a legal and regulatory framework, the rapid proliferation of banks was accompanied by extremely weak management, indiscriminate lending practices and an associated build-up of poor quality assets, which led to new losses of people's deposits – now in the new environment.

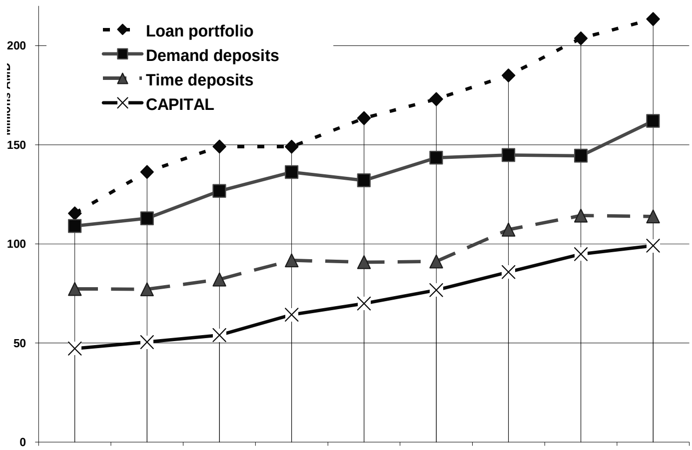


Figure 33. Selected banking sector indicators dynamics

Within the framework of the comprehensive programme for macroeconomic stabilisation, in the mid-1990s, Armenia initiated a programme of bank reform and consolidation. Since then, the banking system performance has continually improved: banks are well-capitalised, liquid, and profitable and the system in general can be considered as sound and mostly adherent to the international banking standards. The most recent trends include growth of credit to the private sector and especially, consumer loans to individuals, continued at a rapid pace, albeit from a low base, while the quality of loan portfolios remains sound. Figure 33 gives a graphical presentation of the growth of some key banking sector indicators, such as capital, loan portfolio and deposits. Nevertheless, the average lending-deposit rate spread remains quite high (12.4 percentage points), suggesting high credit risk and continuing inefficiencies in the banking system reflecting, inter alia, a high proportion of non-interest expenses in total expense structure, inadequate competition and weak bank corporate governance[7].

Deposits in Banking Sector

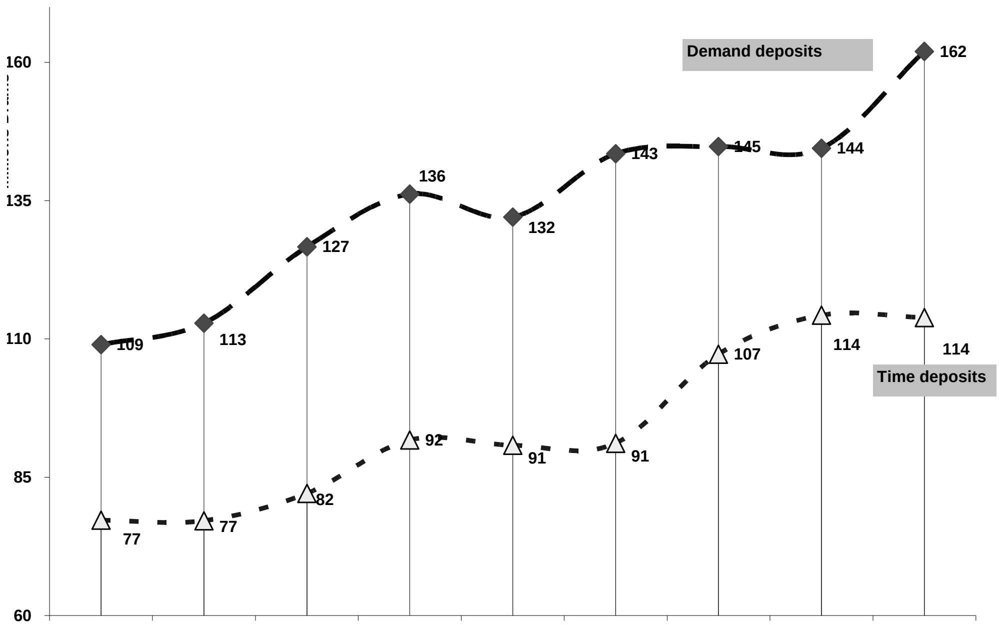


Figure 34. Dynamics of demand and time deposits: 2005-2007

The volumes of both time and demand deposits have increased over several years, though not at the pace desired by the Central Bank of Armenia. As

[7] IMF Staff Report: First Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility. Page 9

illustrated in Figure 34, in the last two years both the demand and time deposits have increased by more than 48% and by the end of first quarter 2007 reached 162 billion and 114 billion drams respectively.

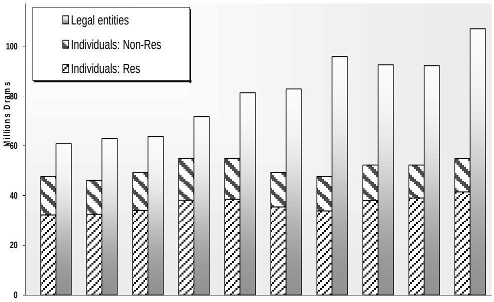


Figure 35. Dynamics of demand deposits: individuals vs. legal entities

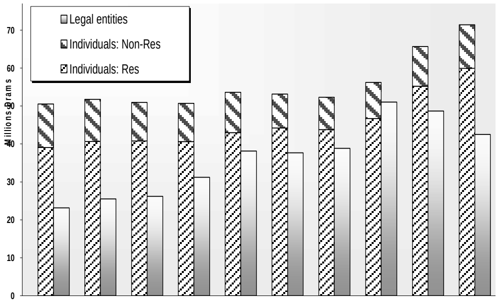


Figure 36. Dynamics of time deposits: individuals vs. legal entities

The two figures above illustrate the dynamics of demand and time deposits split up by individuals (resident vs. non-residents) and legal entities. Clearly, legal entities' funds are mainly kept in the banks as demand deposits, while individuals are more inclined to keep funds for certain time at higher interest rates.

EXISTING SAVINGS PRODUCTS OVERVIEW

Table 2 Existing financial products (grouped)

Name	***Bank/CO***	***Financial Products***										
		Loans										
		Car loans	***Consumer loans***	***Education loans***	***Mortgage***	***Business loans***	***Agricultural loans***	***Leasing***	***Factoring***	***Card deposit***	***Educational deposits***	***Child's deposits***
ACBA-Credit Agricole Bank	B		*	*	*	*	*			*	*	*
ACBA-Leasing	CO							*				
Agroleasing	CO							*				
Araratbank	B	*	*		*	*						
Ardshininvestbank	B	*	*	*	*	*	*			*		*
Aregak	CO	*	*			*						
Areximbank	B	*	*		*	*						
Arfin	CO	*	*		*							
Armbusinessbank	B	*	*	*	*	*						
Armeconombank	B	*	*		*	*						*

Armenian Development Bank	B	*	*		*	*				*		*
Armimpexbank	B	*										
Armswissbank	B					*			*			
Artsakhbank	B	*	*		*	*						
Bank Anelik	B	*	*		*	*	*	*				
Bless	CO	*	*									
BTA Investbank	B	*	*		*	*						*
Byblos Bank Armenia	B		*		*	*						
Cascade Bank	B	*	*		*	*						
Cascade Credit	CO							*	*			
Converse Bank	B	*	*		*	*	*					*
ECLOF UCO	CO											
First Mortgage Company	CO	*	*		*							
HSBC Bank Armenia	B	*	*		*	*						
Inecobank	B	*	*		*	*	*					
Izmirlyan-Eurasia	CO											
Malatia	CO		*									
Mellat Bank	B											
New Horizon												
Norvik	CO	*	*		*							

ProCredit Bank	B				*	*						
Prometey Bank	B	*	*		*	*						
SEF-international	CO		*				*					
Unibank	B	*	*		*	*				*		*
VTB Bank (Armenia)	B	*	*	*	*							
Washington Capital	CO		*		*							

* - indicates that the bank or credit organization has the particular product

Two main groups of institutions operate and offer financial products in the financial sector of Armenia: banks and credit organisations. Credit organisations are divided into the following groups: leasing, factoring and former microfinance institutions.

Table 2 presents products (loans and deposits) currently existing in the financial sector of Armenia. During recent years, car loans, consumer loans, mortgages became especially popular among Armenian households. These are smaller loans, the demand for which grows in parallel with increasing employment. Some banks provide educational/tuition loans, taking into consideration the specificity of the Armenian national mentality, that people consider the education of their children to be extremely important. There are also loans provided for Small and Medium enterprise (SME) development and rural development. Both these directions are important since SME development and rural development are issues of strategic importance to Armenia in terms of poverty reduction policy.

There are currently practiced loans for which deposits serve as a guarantee. There are also few banks which offer child deposits and/or educational deposits again based on national mentality, i.e. special attitude towards children and education. Currently, one of the banks offers deposits that provide an opportunity to participate in lotteries or offer other holiday deals - these work better than other deposits.

For credit organisations the most common types of products are micro loans and group responsibility loans, although they offer other types too. Credit organisations are more active in rural development than banks in Armenia.

There are some leasing companies operating in the financial market. They claim to perform a very important function for the country in terms of technological and innovations development. According to these companies leasing of assets needs to be supported by the government, privileged conditions should be offered, since leasing of machinery contributes to the flow of modern technology and machinery to the country.

Recent Developments

Some of the banks have expanded their activities in such areas as the provision of agricultural loans, trade financing and others.

The main development in recent years has been that many of the banks improved terms and conditions of their financial products, diversified contracts for different financial products. New products were also introduced.

Most of the credit organisations have recently changed their legal form and registered as universal credit organisations, while previously they acted as NGOs or foundations. This brought them under a more professional field legally regulated by the Central Bank of Armenia (CBA). Registration as universal credit organisations allowed them to lend business loans, and enter a regulated operational environment.

More banks have been providing loans for rural development and small business development purposes.

During the last 3 years some of the Armenian banks expanded their branch networks.

A special product designed and proposed by one of the banks is a new type of accumulative deposit which will provide both options in one: to accumulate and to deduct, i.e. over the entire period assigned by the contract a client can accumulate or deduct money without losing any interest (this product is not related to remittances).

During recent years a special type of product was also introduced: loans with salary as collateral, this product also requires additional collateral in the form of assets, but in some cases if the client’s employer is trustworthy, salary is considered enough guarantee for getting a loan.

Recently, by developing and improving their products Armenian banks have been trying to apply flexible and individual approaches to their clients.

LINK OF SAVINGS PRODUCTS WITH REMITTANCES

The banking institutions that cooperate with MTOs[8] and host MTO service points within their institutions, practice remittance-backed deposits and loans. The main goal is to keep a part of the money that flows through bank within the bank.

The survey of the Armenian financial sector participants suggests that about half of the Armenian banks use remittance payment history in lending or attracting deposits (this result confirms the finding in the ADB report on Remittances and Financial Sector). Some of the credit organisations do not use remittance payment history as a base for lending, since they consider it to be risky and they mention lack of knowledge and experience that credit organisations currently face.

In most of the cases (for almost all banks and credit organisations) the link between savings products and remittances is indirect, i.e. remittances are considered as a secondary as opposed to a primary income source. This is because for income justification in lending processes remittances are considered to be an unstable and risky income from the banks and credit organisations point of view[9].

In some cases only 25 percent of remittance flows is considered as a secondary source of income for loan repayment. Other banks and credit organisations mentioned schemes that considered 50 or up to 70 percent. Almost all banks and credit organisations (with the exception of one bank) do not consider 100 percent of remittances even as additional source of income, since they consider this as risky and financial institutions try to balance risks.

However, almost all financial institutions mention that the amount of flows and number of clients who are remittance receivers is so big that it is impossible to ignore them. Migrant remittances are mostly linked with

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[8] There is a special license granted by CBA to all institutions that transfer remittances. Also, banks, by definition, can do such transactions.

[9] This is a misconception, since remittances can be considered one of the most stable sources of income and very important in case of crisis, as they are most of the time counter-cyclical.

consumer loans, car loans, mortgages, or small loans[10]. However, there are also cases when remittances are considered for business or corporate loans, too (although the size of consideration is negligible). For instance, one of the banks remittances for corporate loans plays a role of 3rd or 4th level of importance.

Some of the credit organisations have set a clear policy of fostering income generation within the country. That is why they do not rely too much on remittances when making lending decisions. Some do not consider remittance flows at all, and their attitude is negative, since according to them, consideration of remittance-backed lending does not lead to economic development, remittances are not the type of income generated in the country. Their goal is that clients generate income in Armenia as a result of doing business. Besides, they consider the efforts and costs of remittance consideration to be unjustified and a waste of time. There is also opinion that the population and financial institutions are not ready to wider use of these schemes yet, as the level of financial literacy is low.

Remittances are mostly considered to assess the client's credibility/solvency on an individual or family level.

Existing Schemes

Remittance- backed lending

In most of the cases banks and credit organisations require statements or receipts from remittance receivers to prove the remittance flows. But there are rare cases when the bank relies solely on the client's words when considering the remittances as a source of secondary income (this is an individual approach, only for clients with a long credit history). In microfinance, the situation is a bit different, there are highly experienced agents working in Marzes, who are very well informed of the clients' financial situation, and know whether or not they have migrants sending remittances. In small areas it is easy to be informed, and often there is no need to prove

[10] source: Armenian financial sector participants survey

remittance flows by documents or statements, a more informal approach is used. As the head of one of the credit organisations mentioned: *"Microfinance is very inclusive. Our work is related to high risks. The micro loans that comprise a very big share of our loans are under risky zone. However, we have very high repayment rates. Our loan officers are very experienced and well-informed, they can serve 400-500 clients and they can visually assess credibility with high reliability level. The same informal mechanism works for loans in urban areas, although the average loan amount is higher in urban areas."*

The minimum time requirement is to provide proof for at least 6 months, at times the period from 6 months to 1 year is also applied. However, the longer the period, the better.

Usually, it is preferable that clients provide proof on monthly flows, although sometimes, quarterly flows are also enough if they are regular.

Remittances are mostly considered as a secondary source of income. Beneficiaries of these schemes are individuals, and sometimes, even businesses. Almost in all cases there is no differentiation between rural and urban area clients who use remittance-backed products, they are offered equal opportunities. Only in cases of leasing there are some benefits provided to clients from rural areas: part of the remittances that covers no more than 10-20% of total leasing liability is taken into consideration, in rural areas it is 30-40%. Also in microfinance, a special approach is applied for clients from rural areas, since they account for most of the microfinance clients, and the fact of receiving remittances can be checked without special documentation. But in general, in urban areas demand for remittance –backed products is less than in rural areas, since people in rural areas (farms, sole proprietors) depend more on remittances.

As mentioned earlier, in some cases only 25-30 percent of remittance flows is considered as a secondary source of income. Other banks and credit organisations mentioned schemes that considered 50 or up to 70 percent. Almost all banks and credit organisations (with the exception of one bank) do not consider 100 percent of remittances even as an additional source of income, since this is risky and financial institutions try to balance risks. Usually collateral and/or a primary income source is required (which can be the client's salary or other income generated in the country). One of the banks in 60% of cases takes into consideration the remittance flows. This bank requires collateral, but considers remittances as *primary income*. But in this case, the interest rate is a little higher, 16% instead of 14%. The mechanism is where the monthly repayment should make up 40% of the family income and 50% if the client has more than one loan.

In general, income which is not justified by relevant documentation is not considered. However, one of the bankers mentioned that sometimes clients succeed in justifying the remittances that are sent through relatives or friends/ or in general through unofficial channels and so, if the banks are "inclined "to lend, then they lend. There is an element of subjective assessment, but the bank tries to apply flexible and constructive approach particularly to loyal clients.

According to representatives of financial institutions, banks manage to keep only 15%-20% of these amounts within the institutions, remittances mainly come for a purpose and mostly for current consumption.

Interviewed representatives of financial institutions often mentioned the seasonal character of remittances: the peaks are in summer and New Year's Eve.

Remittance- backed deposits

There is another scheme, a deposit product currently existing in the financial system designed for remittance receivers. Clients, who receive remittances through a certain bank or an MTO located in the bank, get an opportunity to deposit a part or the entire amount of the received remittances. Usually a minimum deposit requirement applies for this product (for example USD 300 for remittance receivers through the Anelik system, or USD100 for remittance receivers through Unistream. Anelik offers a slightly higher dividend). Although for this product the interest rate is slightly lower[11] than for regular deposit products, but in some banks dividends are paid in advance. In spite of that this product is not very popular among remittance receivers. They say that money they receive is for current consumption, not

[11] For example clients who receive remittances through Unistream are offered: 5% for 1 moth period, 6% for 1-3 moths, 7% for 3-6 months, 8% for 6-12 months.

for saving. Mainly small amounts for current consumption or targeted expenses flow through MTOs.

One of the leasing organisations (LO) practices the following scheme: clients have an opportunity to accumulate and deposit some share of their remittances in the partner bank of this LO, for the purpose of early repayment of leasing. Hence, they deposit remittances and they get a chance to repay early, avoiding additional interest payments and without paying penalties. This mechanism works and is more popular among farmers.

Potential for Improvement

Possible improvement of existing remittance-backed schemes is an issue of strategic development. Financial institutions should make a cost and benefit assessment of efforts required to keep the remittance flows within the institutions. There is also a need for exposure to the international experience where some banks have successfully leveraged remittances to the benefit of their clients and themselves.

The idea of improving existing remittance-backed financial products did not seem to be approved in general by the Armenian bankers. They think that currently there is not too much potential for improvement of existing schemes and making them more efficient, and they are not very willing to consider the opportunity for tapping into new clientele through remittances. Credit organisations seem to be more flexible on this issue.

Bankers mostly think that the scheme that they already have is the most optimal and there can hardly be a way to refine it more. Some banks mention that cases when people want to back up their borrowings with remittances are not frequent. Hence they do not see problems related to product improvement. Clients already borrow; there is enough demand for loan products.

The research team had discussions related to improvement of existing remittance-backed savings products in three directions: 1.improvements in terms of increasing the percent of remittances that are considered as a secondary source of income when lending money, 2.improvement of terms of deposit products offered especially to remittance receivers and 3.intensification and development of new remittance-backed products.

1. As regards the increase in level of remittances that are considered as an additional source of income, respondents do not think there is reason to increase the level of remittances that are taken into consideration. This is a statement made by those who consider only 20 percent and by those who consider more. Today financial institutions consider 20-70 percent of remittances as regular source of secondary income, which is additional proof of solvency when making the lending decision. Only one of the banks considers remittances as a primary source of income. But mostly respondents mentioned that increasing the target level they currently use can lead to increasing risks.

2. As mentioned above, the deposit products offered to remittance receivers are not very popular and do not work very efficiently. The reason according to the respondents is that they receive small amounts, besides these amounts are mostly sent for a certain purpose, therefore even if a part is saved, it is saved for that purpose and, not for depositing in the bank. Most of the money is for current consumption, and even if a certain portion is for savings or investments, the purpose is decided in advance (e.g. for buying houses, investing in a business). Rarely is something left after investing the money, which can later be deposited in the banks. Deposits that offer special deals work much more efficiently. Hence, they do not see a necessity in the improvement of remittance-backed deposits.

3. As regards the development of new savings products, respondents mentioned that they avoid entering new risky markets. They currently consider there is no need for improvements, if the market becomes overwhelmed with the existing products and when the search of new markets starts they will consider it more intensively. Banks consider remittance-backed schemes to be risky not only for them but also for their clients.

Some of the credit organisations mentioned that they follow a special policy of making their clients self-sufficient: after getting remittance-backed lending once or twice, clients gradually become self-sufficient; and therefore for these organisations there is no need for further improvement of remittance-backed products. Since most of them currently operate in a regulated field, CBA can consider it subjectively unjustified, if they rely too much on remittances. Besides, it is hard to take remittances into consideration in case of business loans; for consumer loans there can be some improvements made, but they aim at business development and fostering sustainability.

Some of them think that credit organisations in Armenia are not ready for improvements yet, because they did not explore the existing best practices and opportunities. Some credit organisations suggested that the banks give guarantee letters based on remittances, since it is easier for banks to control the remittances flows. Sometimes, too much effort is required for getting information on a client. Credit organisations are unwilling to consider remittances for group responsibility loans, since it is hard to get information on all group members.

However, some of them see potential for improvement: remittance-backed products can be improved when clients realise that they can borrow from credit organisations under more favourable conditions than from banks. Clients of credit organisations and microfinance institutions are often those rejected by banks. If the legislation allowed credit organisations to attract funds or if savings accumulation mechanisms[12] for UCOs worked successfully, they would be able to introduce more efficient schemes involving migrant remittances. But this is an organisational issue and remittance amounts will remain uncontrollable and risky.

Some credit organisations think of considering remittances when developing new products.

According to some independent experts the banks have no motivation to attract new clients and to enter new markets, since demand for financial resources exceeds the supply, banks search easy ways to make money.

[12] (funds accumulation by responsible group members themselves, since legally credit organizations cannot attract deposits)

Financial institutions do not set a task to observe best practices, to expand client base, they just ignore this field.

However, the main apparent potential is that annually more than USD1 billion flows to Armenia as migrant remittances, and this tendency is more likely to continue in the near future, given still a rather high level of unemployment and scarce opportunities for doing business in the country[13][14].In rural areas there is more potential for improvement: the mechanism will work better, since it will be easier to provide agricultural loans, which will be repaid using the remittances; people in rural areas are more dependent on remittances more, the market is bigger there, although a risk might incur if the rural to urban migration is strong.

Several special schemes were/are planned by some of the financial institutions in order to improve existing remittance-backed products, but they are still on paper. Some such schemes are presented below:

- One of these ideas was to issue a credit card for those who receive remittances through a certain money transfer system (Unistream).

- A client can deposit money in the bank: more specifically, the client leaves the remitted amount in the bank as a deposit for three consecutive times, and gets a loan the amount of which is 2-3 times more than the accumulated deposit amount (a similar scheme is used by couple of institutions).

- If tuition loans are provided for a longer time period it could be more beneficial to back these loans by deposits for remittance receivers. The current situation is not very beneficial, since tuition loans are normally provided for up to 1 year, while the interest rate for deposits is quite low to offset the loans rate. A longer period is needed for this procedure to be more beneficial.

[13] Source Radio Free Europe Caucasus Report, The CIA World Factbook, International Financial Statistical Database, Chapter 4.1.
[14] Source Radio Free Europe Caucasus Report, The CIA World Factbook, International Financial Statistical Database, Chapter 4.1.

- Clients, who have rented spots in various malls, can deposit money for 2-3 months and after that take a loan of 3 times as big an amount of the deposit. This mechanism will work better with a longer as opposed to a short time period.

Barriers to Popular Use of Existing Products

Most people have a negative perception of financial products, which is due to lack of knowledge. The level of financial literacy is still low. In general, financial education is a very important aspect in any initiative on remittances. Therefore, some experts suggest introducing classes in the last years of high-school. However, this should be not only through school, but also through pre-departure migration curricula, through migrant associations, etc. There is also large potential for public/ private partnership.

Some credit organisations do not want to force people to justify remitted income by banks statements, since it forces them to send money through banks. A third party is needed to train people, to introduce the advantages of using financial instruments, to promote cashless transactions, to form a financial culture among people and increase the level of financial literacy.

- **Accessibility**

Some financial institutions do not have an expanded branch network, especially in rural areas.

- **Lack of government support**

Leasing needs to be supported by the government, privileged conditions should be offered to leasing companies, since leasing of machinery for instance, contributes to flow of modern technology and machinery to Armenia. One of the suggestions would be application of the accelerative depreciation schemes in accounting for leasing companies. The same accounting methodology is applied for leasing institutions and other financial institutions, this increases costs and as a result, there is no difference for clients between taking a loan from a bank or leasing.

- **Lack of trust**

Another barrier which is especially typical for rural areas is that clients are resistant to giving information on remittances they receive, it is an issue of mistrust, which is being resolved gradually.

- **Awareness**

There is still a lack of awareness of and financial literacy in the financial system.

- **Use of informal channels**

Sometimes formal justification of remittances is difficult since money comes though informal channels; some people avoid using formal channels, also due to high costs associated with it.

- **Demographic situation in rural areas**

In rural areas, from where a young labour force migrated, mostly old people reside and receive remittances. These people are not interested in using financial instruments, they are consumers.

- **Distrust towards banks**

After the events of 1990s, there is still some level of distrust left towards banks.

- **Lack of information**

Credit Bureau provides information on clients that have loans of more than AMD 1.5 million, and no information on those who borrowed less.

Besides, when checking the primary source of income of a potential borrower for which remittances might be the secondary source, there is no information database to check whether a company is actually operational, therefore when a client brings a certificate from a company, financial institutions must spend a lot of effort to check whether or not the company actually operates.

- **Low level of income and high unemployment**

The overall low level of income generation among the population and particularly high level of unemployment in rural areas, result in an inactive use of the existing financial products.

- **Poor condition of infrastructure**

In rural areas farmers cannot use their land efficiently and produce enough harvest due to poor infrastructure and irrigation. They do not get satisfactory results on their work; hence, they do not make enough money to repay loans.

BARRIERS AND DIFFICULTIES IN DEVELOPING REMITTANCE-BACKED SAVINGS PRODUCTS

Difficulties related to development of remittance-backed savings product can be presented under the following groups:

Mentality

Mentality - "Armenian people do not like new things" according to some respondents." Armenians are traditional. They have a special attitude towards work – they want easy money and do not want to spend extra efforts. For instance, one of the credit organisations tried to apply the scheme of money accumulation by members of group responsibility loans, which could even ease the payments" burden, but it did not work.

Technical problems with income justification

Particularly in rural areas people do not keep receipts, and it creates additional hurdles for them to get a new statement on transactions. Hence it is important that the culture of "keeping receipts" is formed or maybe find other recording means. A big obstacle anyway is the informality of a large amount of remittances.

Sometimes in Marzes (regions) it is technically more difficult to present formal documents justifying remitted income than in urban areas (although they have problems in justifying any sort of income, not only remittances). An example of a technical problem is that in microfinance in the case of group responsibility loans the number of group members can be as high as 25, hence it is hard to request information for all of them, unless a leader is chosen, but then difficulties would arise related to defining the responsibility[15].[16]

There are cases when the bank does not consider receipts if those are brought from other banks or MTOs in other banks, unless the client is very trustworthy with a very good credit history. In case the client received money through an MTO located in a particular bank, the bank still has the information in their system, even if the receipts are not available.

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[15] One should note that normally collateral agreements are signed on an individual basis

[16] One should note that normally collateral agreements are signed on an individual basis

Legislation

Credit organisations perceive legislation as a hurdle for developing remittance-backed products. Current legislation does not allow credit organisations to attract deposits, as opposed to banks which can offer a client credit line if the latter keeps savings in the bank. For the clients of credit organisations banks are unaffordable, most of the clients were previously rejected by banks and later chose LO. It would be more efficient if credit organisations are allowed to attract funds even with certain limitations compared to banks as a source for lending. Previously a certain mechanism of savings attraction was applied in credit organisations. Although MFIs did not have a right to pay dividends, but applied that mechanism to form a habit among their clients, clients were asked to accumulate some amount of their savings and, after repayments, they received the money back, which is called mandatory savings. Thereby, clients were securing themselves from risks having accumulated money at the time of payment.

Practicing this mechanism has been stopped because of legislation. Microfinance institutions use this practice of linking savings and lending, but not in Armenia, as it is illegal. Before entering the CBA licensing system Aregak and Kamurj were practicing this mechanism. Money was collected by group members and they could even use it for repayment purposes.

Lack of skilled specialists

Not only there is a lack of skilled people who will design efficient products, sometimes insufficient commitment to work can be witnessed.

Lack of motivation

There is no motivation for banks to attract new clients and to enter new markets, since demand for financial resources exceeds the supply, banks search easy ways to make money. Financial institutions do not set a task to observe best practices, to expand client base, they just ignore this field.

Risks related to instability

Banks consider (often wrongly!) remitted income flows to be unstable in either rural or urban areas. Clients can bring statements proving flows for one year, but then flows can be suddenly interrupted. Financial institutions perceive it as waste of time when requesting a statement proving remittance flows from banks.

Risks related to control

If the MTO through which clients receive money are located in institutions other than the lending institution, remittance flows become more non-traceable; clients can bring fake statements. That is why remittances are considered as a secondary source of income and collateral or other guarantees are applied in any case.

Use of remittances is predetermined. *Remitted amounts are usually small and are mostly spent on current consumption. There are villages where the main labour force has migrated, and the money the elderly population gets, is for consumption. The elderly population consists mostly of non-bankable clients; they do not even care about lending or depositing.*

In general, migrant remittances mostly come for a purpose, and even if a part is saved, the purpose of saving is predetermined; it is not for depositing in the bank. There are cases also when money is sent for investment, but the direction is already known. Only if some extra money is left after the investments and expenses are made, remittance receivers might consider depositing these amounts in banks, but these amounts are very small and would hardly be deposited.

Seasonality

Remittances are mainly seasonal. Mechanisms taking into consideration this seasonality and attempting to regularise it might be considered.

FINANCIAL RISKS RELATED TO REMITTANCE-BACKED PRODUCTS

- **Instability**

Though globally the World Bank (Dilip Ratha) suggests that the flow of remittances is counter-cyclical and a stable source of income, Armenian banks perceive remittances as unstable income; there is no guarantee on continuation. That is why remittances are mostly considered as a secondary source of income for clients' repayment.

- **Realisation of collateral**

This is also problematic, even in cases when remittances are considered as secondary income. For the realisation of collateral, banks and credit organisations should go through court procedures etc. In case of leasing, it is different: since there is no collateral requirement (the object of leasing is collateral itself), there is no risk related with collateral realisation.

- **Risks related to control**

If the MTOs through which clients receive money are located in institutions other than the lending institution, remittance flows become more non-traceable; clients can bring fake statements. That is why remittances are considered as a secondary source of income and collateral or other guarantees are applied in any case.
Also there is risk that borrowers will make fake transfers in order to get a loan, and after the loan is provided, flow of remittances will stop. Even if this issue is somehow included in the loan contract, there is no guarantee that the flow will not be interrupted. This is how the issue is perceived by the banks, since there is never any guarantee, an employment contract can also be terminated

In general, remittance flows are hardly controllable. In terms of control from the lending/deposit taking institution’s point of view the status of migrant is relevant as well - if he/she stays illegally in a foreign country, remittances flows could be less reliable.

- **Risks of non-payment**

In any case relying only on remittances is believed to increase risks of non-payment; in case of corporate loans the risk is negligible. The risk is higher for consumer loans.

- **Currency risk**

If clients receive their money in USD, and take a loan in AMD, in case of AMD appreciation clients may have difficulties to repay.

There is an opportunity offered to Unistream clients: for those who choose to take remittances in AMD, no service fee is charged, but mainly people avoid this option, especially old people, they want to get their money in the currency of sending. This is a psychological factor: they think if they take it in AMD that will be different money, and they are afraid of being cheated.

Some of the institutions' perception is that there is not too much risk, since remittances are not considered as a primary source of income and are just additional information for lending. Using such a strict approach financial institutions try to decrease clients' as well as their own risks. In case of remittance-backed deposits there is no risk.

FORECAST OF DEVELOPMENTS

There are two opposite forecasts on development of remittance-backed schemes.

One group of respondents thinks that these schemes have a future in Armenia, since more than 1 billion USD flows into Armenia. And this tendency seems to continue in the near future. (According to the ADB report, there is little evidence that growth of remittances into Armenia may discontinue in the future).

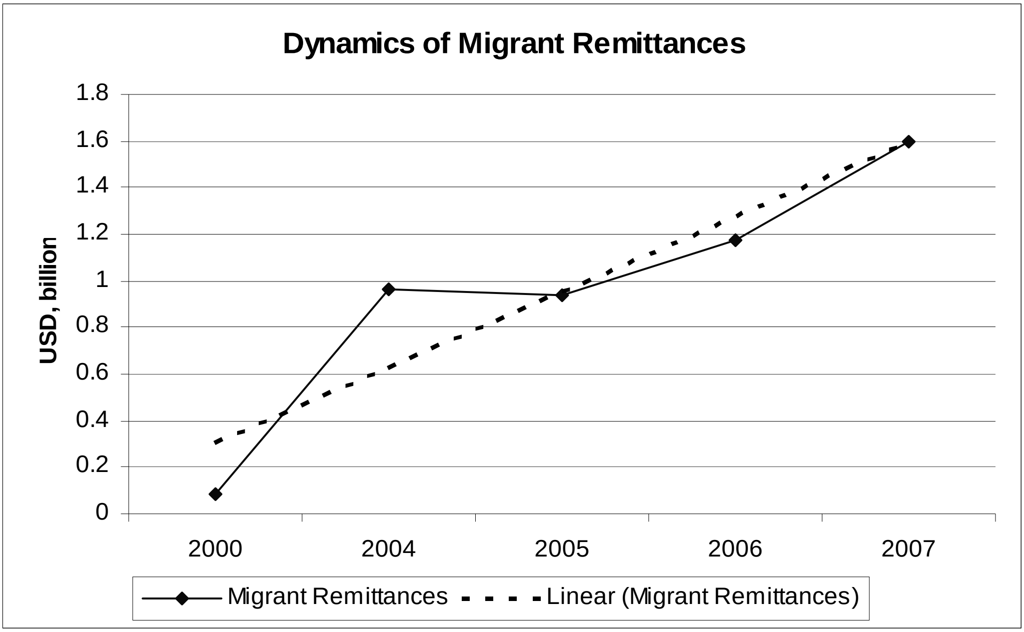

Figure 37. Migrant remittances, 2000-2007

The other group is more sceptical: supporters of this view think that on a macro level these schemes will remain at the same level of development, but on a micro level, share of remittance-backed products will decrease: as remittance receivers take loans and become more self-sufficient, new jobs are created, they will gradually become independent from remittances.

The first group which perceives that these mechanisms have future further elaborate:

- These mechanisms can become popular, since many remittance receivers take small loans and remittances can be better linked with small loans. Besides, remittances will continue to flow to Armenia, at least in the near future, since opportunities for income generation and doing business are not very big in the country.

- If labour force migration in the country continues and people continue to rely on remittances, more money will flow into Armenia and these mechanisms will definitely develop.

- There is a potential for development of remittance-backed products, if mechanisms are created, which allow accurately identifying income sources. If there are special more transparent internet and mobile phone networks through which people will send money, the process will become more easily traceable and will develop. Time is required for these processes to develop.

- There are opinions that in Marzes remittance-backed mechanisms have better potential to develop, since people rely more on remittances. In Yerevan the market for remittance-backed lending is not big.

- If products are properly designed by professionals then they might be efficiently applied. It can also lead to increasing money transfers; if the money migrants send is efficiently used for investments, then migrants might send more.

- In the context of current networks, channels and level of development, remittance flows are more traceable for banks and they have better chances for use of efficient mechanisms, since legislation allows them to attract deposits.

- Considering significant amounts flowing into Armenia as remittances, they are believed to become backing up mechanisms for almost all banks in the country.

- More restrictions on cash flows are expected when cash flow regulations in Armenia become stricter. Financial institutions can track were the remittances come through; in other words, when the system develops and non-cash transactions become more popular, remittance-backed mechanisms will develop and improve.

- Over some time banks will consider remittances more intensively.

The second group for whom popularity of these mechanisms has less potential:

- A big share of remittances is transferred through informal channels. If in several years time the field becomes more regulated and remittances are transferred through internet, mobile phones or other formal ways (which are more controllable, maybe after 2010) then attitude and applied schemes can be improved or changed or even expanded.
- On a micro level the share of remittance-backed products should decrease over time, since many of the financial institutions and especially credit organisations (former MFIs) apply policies which lead to it. Clients become self-sufficient over time, since the applied policies make clients generate income in Armenia, clients become independent from remittances and their need for remittance-backed products gradually disappears.
- If the economic situation improves in the country, remittance flows will decline and banks will rely mainly on salaries or the main income. Otherwise these mechanisms will become more popular.

MECHANISMS TO LEVERAGE REMITTANCES FOR ENHANCED DEVELOPMENT IMPACT

Before summarising the general conclusions about the mechanisms to attract savings from migrants for the purpose of economic development, it is important to state that **while labour migration has the potential to generate positive development benefits it should not be regarded as an alternative to sound policies for home country development[17].**

SUMMARY OF REVEALED GAPS AND OPPORTUNITIES TO ATTRACT SAVINGS FROM MIGRANTS

According to CBA estimations migrant remittances of about 1.5 billion USD flow into Armenia. The household survey results show that 7-8% of remittances are saved for various purposes; hence the potential amount of savings that can be attracted into the financial system is assessed to be at least 129 million USD. Even if 5%-10% of USD 129 million is managed to be attracted into the system and used as lending capital, it is already a significant achievement of 6.5-12.9 million US dollars .This is particularly in the light of the fact that the household survey shows that only 3% of people deposits 1-100% of their saved income in banks, so there are, indeed, underutilised opportunities. Remittance-backed mechanisms are believed to work more efficiently with small loans and the size of migrant remittances sent to relatives is usually not so big, hence remittances can be efficiently linked to financial products.

Gaps on policy level are also revealed. In their strategic planning process, banks do not plan products by source of income so strategic planning is done based on residence, by legal status, currency, duration and not by source of income (remittances or income generated in the country).

Another gap is that current legislation does not allow credit organisations to attract monetary assets through a mechanism which could allow credit

[17] Source: international labour migration and development: the ILO perspective

organisations developing more efficient financial products. Also they can host MOTs and act as POS for remittance transfer.

Remittances are considered as a secondary source of income for everyone, although for some clients remittances are the main and regular source of income. There are revealed opportunities which can be used to fill these gaps. As mentioned above, remittances of about 1.5 billion USD flow into Armenia. According to our household survey results, about 8%[18] of income or more than USD 129 million is saved for various purposes. Primary objectives of saving are[19]: 1% of households save for apartment reconstruction, 24% for tuition fees, 28% for healthcare needs, 39% for pension age and 8% for other purposes.

Given these statistics one can estimate total savings from remittances by those who save for different purposes[20]. According to the weighted average methodology, 7% of remittances is saved for special events. Also, according to the CBA estimations, about 9-10% of remittances was spent on education (2006), 4% was spent on house or apartment renovation and about 9% on healthcare needs. Based on these data, potential volume of savings from remittances can be evaluated for those groups which save for some purpose. Thus, it is estimated that about 3.1 million USD is saved for paying tuition fees or expenses on education, about 103,000 USD is saved for buying a house or apartment renovation, about 112 million USD is saved for special events and about 3.3 million USD[21] is saved for healthcare needs.

Hence, there are still underutilised resources and opportunities in terms of attracting migrant remittances into the financial sector.

In the next section new mechanisms to fill these gaps, as well as mechanisms on how to activate existing remittance-backed schemes, are proposed.

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[18] Weighted average methodology was applied.

[19] Assumption is that the pattern of savings behavior (objectives of saving) is the same for gross income and remittances.

[20] A simplifying assumption was made: assume that the breakdown of remittance receiver households by saving purposes is the same as for all households in Armenia. For example 24% of remittances receiving household save for education, 28% for healthcare needs, etc.

[21] These figures can even be underestimated, since calculations are based on weighted average of savings shares from remittances.

The key opportunities for potential mobilisation of financial resources through migration are presented below:

- Armenian migrants have a strong attachment to their country and many express an interest in returning and investing once sufficient savings are accrued or certain circumstances/conditions are met.
- Migrants' savings - whether retained in the host country or accumulated in Armenia - represent a substantial pool of funds that, given appropriate marketing strategies, approaches, incentives, safeguards and regulatory framework, might be used in savings and investment opportunities in Armenia.
- The pool of finance potentially available can be expected to increase over the medium to long-term, as there is strong evidence that, as the migration cycle matures and immediate needs are met, a larger portion of income gained through migration shifts towards savings and investment.
- The close relationships maintained between migrants abroad through clustering[22] and social networking, and between migrants, their families and home communities, may compensate for many of the well-known risks associated with financial intermediation in Armenia, which deter migrants from remitting their savings (due to institutional, regulatory and other issues). This social phenomenon may also present an opportunity to identify and mobilise the financial resources of diaspora members and high net-worth individuals with an interest in investing in a home community or enterprise.

Revitalising Existing Remittance-Backed Mechanisms

Aside from new mechanisms that are proposed in the next section, we would like to describe some existing remittance-backed schemes and suggest ways to intensify them.

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[22] This refers to the phenomenon by which the mutual-help and social capital offered by 'leading' relatives, neighbours and friends encourage others to cluster around these people in the host country. Hence, the choice of destination and also the success rate of the migration experience are often influenced by these familial networks.

Unibank offers “Unistream” deposit, especially to people who receive remittances through the Unistream system. However this product is currently not very popular, according to the bank representative. Even the fact that interests for this deposit product are paid in advance, it does not attract too many clients. The suggestion would be to design a product which links Unistream deposit with lending, in other words, to introduce loans designed for people who deposit part of their remittances. Unibank currently offers loans based on deposit guarantees, but this mechanism is not specifically designed for remittance receivers.

If Unibank offers loan products that clients mostly need, for instance tuition loans (especially that Unibank currently does not have that product), it might be a better motivation to deposit part of the remittances. It has been already mentioned that about 3.1 million USD is saved for paying tuition fees or expenses on education and these potential resources need to be taken into consideration.

Another suggestion is for banks and credit organisations which do not practice tuition loans and/or loans for SME and rural development. We would suggest financial institutions which do not offer these products yet, to introduce loans for SME development especially in rural areas, and/or tuition loans to those who deposit remittances.

PROPOSED NEW REMITTANCE-BACKED FINANCIAL MECHANISMS

Principles for developing new mechanisms

When developing new remittance backed mechanisms we relied on findings (gaps and opportunities) revealed from the household survey and in-depth interviews with the banks. These mechanisms aim at filling the revealed gaps and use the available opportunities of attracting remitted amounts into the financial system.

All the mechanisms that we propose are strictly based on the following principles:

1. proposed mechanisms should be financially viable for the institution that is going to apply it;

2. proposed mechanisms must be directly linked to the economic development in Armenia (these should not be products just designed for migrants, they must be targeted: link migrant remittances with the economic development);

3. proposed mechanisms/products must be innovative for Armenia;

4. in the proposed mechanisms, remittances are treated as a *primary* source of income as opposed to treating them as a secondary source, the way it is currently done;

5. proposed mechanisms are based on a clear recognition that remittances are private transfers and that the savings involved belong to migrants and their families, whose primacy of choice in their allocation is paramount

The study has come up with two "main" and three "other" alternative mechanisms to involve remittances into the formal financial sector for the benefit of both the households' livelihoods and the overall economy.

The "main" mechanisms have no privileges over the "other" mechanisms, it is just that the latter are relatively simple and need no deep methodological explanations, whereas the first two are elaborated with a much greater level of detail.

MECHANISM 1. MIGRANTS SAVINGS AND INVESTMENT TRUST

Rationale for MSIT

The MSIT is anchored to the revealed specific problems with migration and economic development in the rural areas; as well as the opportunities that the migration gives in terms of accumulation of significant amounts of money in migration. The existing financial institutions have not paid serious attention to the migrants as a client group and their savings, as a potential investment resource, remain unattended. MSIT is an attempt to partially solve the rural economic depression problem through mobilising the migrants' savings and reinvesting them into their own communities with the aim of bringing back their and their families' interest in staying and building their homes.

General Goals

The principal “umbrella” goals of the MSIT after its institutionalisation will be:

- Attraction of migrants’ savings to re-invest in their home communities through offering guaranteed deposit or/and project co-ownership opportunities in line with the numerous needs, priorities and objectives of the migrants themselves.

- MSIT will seek commercially viable and feasible projects (business opportunities) in rural areas for lending or investing migrants’ savings and own funds.

The **mission** of the MSIT will be to CONVERT THE LABOUR DRAIN TO SOCIAL GAIN by setting up a financial intermediary, which will fill in the gap and use the opportunities, on the one hand, and bring the solution to the problem, on the other hand.

Important Constraints

- MSIT will be a well capitalised financial institution and a significant player in the Armenian financial market. It should therefore not distort the financial market by providing too concessional conditions, but rather complement the existing financial framework.

- Though donor funding will play a significant role at the outset, MSIT will aim to be financially viable in the long run: strategically, the investment and lending will be matching the funds attraction opportunities – both price-wise and term-wise.

- Though the GoA will have an important role in advising the MSIT on the most impoverished and in-need regions and communities to target, the MSIT will be an independent financial institution with high class management employed and as little government intervention as possible.

- The Armenian legislation provides a fertile soil for the establishment and operations of the MSIT, so it will be set up and operating within the existing framework in strict compliance with the local regulations.

- MSIT will in the long run aim to have a smooth exit of the donors and further incorporation/securitisation to become a fully privately owned and professionally governed financial institution.

Products Offered by MSIT

MSIT will attempt to provide the full range of financial products to the migrants to help them achieve their objectives linked to their families and their homes, except the goals connected exclusively with the place of migration (e.g. MSIT will not finance buying a home in Samara so the migrant can move his entire family there), including the following:

Products oriented at needs of rural inhabitants earning money in migration (migrants' needs), including:

- *Helping migrants achieve their long-term saving objectives;*
- *helping migrants set up or invest in business back home;*
- *helping migrants return and re-settle back home;*
- *providing a more attractive and safe place to keep savings*

Products aimed at rural economic development (migrants' households needs), including:

- *Generating jobs for migrant household members;*
- *Developing social and economic infrastructures in home communities.*

Mechanism of Work

General Framework

The key element in MSIT operations which will build its success will be **filling the currently abandoned niche** in the financial market, aiming at mobilising savings from the migrants for the purpose of economic development of their home communities, which currently have limited economic capabilities. The critical part of the economic impact of creating sustainable jobs in the communities will come from the SMEs (newly set-up or injected with fresh cash, ideas and management), which will be mainly financed by the MSIT, by both credit and equity. The SME projects, carefully identified and scrutinised by the MSIT experts, will be presented to the migrants through the hired Rural Migrant Coordinators, constantly operating and financed by the MSIT, which will be reputable people with strong influence over the compatriots, even those who have left the country several years ago. By presenting the opportunity, which would both be a lucrative source of income for the migrant and an opportunity to be of real assistance to their home communities, it also creates ground for the migrants' children to have the option to stay home when they are grown up instead of joining their parents in migration. Meanwhile, along with direct investment and co-investment opportunities, the migrants will have a chance to earn a stable income by depositing savings with MSIT and borrow from MSIT either to solve his/her long-term objectives or to re-settle.

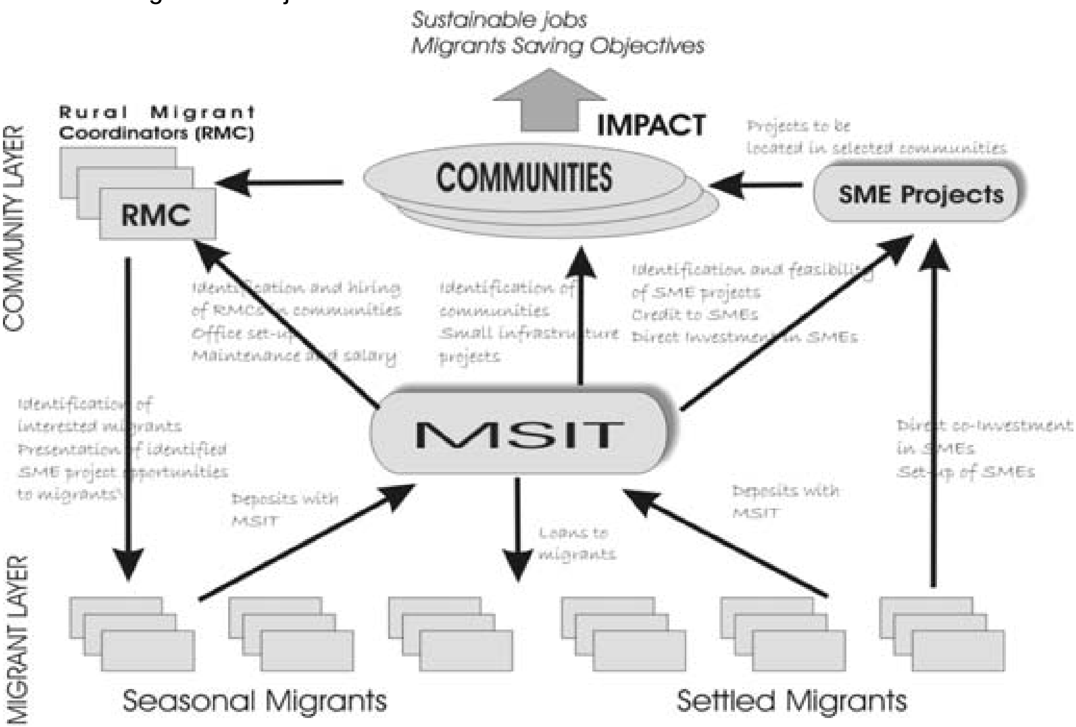


Figure 38. MSIT Mechanism of work

Key components of the overall MSIT mechanism include:

- *Identification of rural communities to target*
- *Employing Rural Migrant Coordinators*
- *Identification of feasible projects for MSIT and migrant investment/lending*
- *Selecting appropriate project financing schemes*
- *Mobilisation of savings from migrants for the selected communities and projects*

Organisational Solution

It is proposed that under one MSIT holding, three institutions are to be established each targeting at one layer of critical operations of the MSIT idea – credit and deposits, investment and research and marketing.

Bank
The bank is the only type of financial institution in Armenia authorised to take deposits. As deposits will be one of the key elements of mobilising migrants' resources, there is no other way but setting up a bank.

Investment Company
Since banks are prohibited to invest depositors' funds in assets of other enterprises, the equity investment function will be undertaken by the Investment Company. The funds of the Investment Company will originate from low-interest long-term loans from the MSIT Bank.

Marketing and Research Unit
Its role will be to do the research of communities, conduct feasibility studies for the SME, perform monitoring and evaluation of all projects, develop procedures and operations guidelines, hire and control RMCs as well as establish and administer their offices, develop and implement marketing strategy and so forth.

For detailed description of Mechanism 1, see Annex 1.

Mechanism 2. Using Remittances to Convert Non-Bankable Micro entrepreneurs into Eligible Borrowers

The rationale of the project lies in bringing together two aspects of the Armenian reality: unmet demand for microfinance in the rural areas and constant and increasing flow of remittances to Armenia.

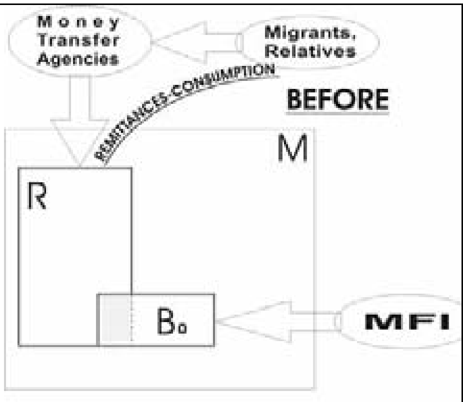
The opportunity that is recommended for consideration of local banks and/or credit organisations lies in the fact that these potential client groups are currently remittance recipients. The key points are that their relatives send home $2,000 to $3,000 annually (which can serve as a base for micro loan repayments) and most of these monies (around 80%!) come in through official money transfer organisations and thus can be tapped.

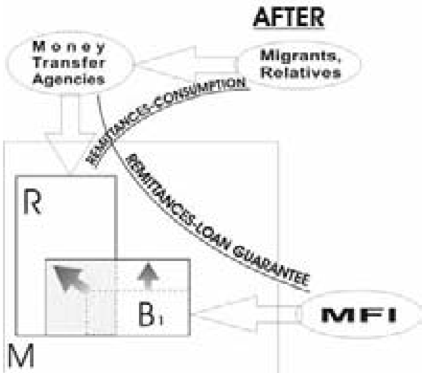
It is extremely important that an innovative mechanism of enabling so far ineligible-for-borrowing rural micro entrepreneurs is proposed, rather than proposing reduction of interest rates or changing the collateralisation mechanism just for the sake of artificially involving more clients and increasing credit risk. This is to be done through using the existing financial arrangements and framework, leveraging remittances that come in constantly mainly for consumption purposes and are not used by the financial sector.

The specific objectives that correspond to the direct outcomes to be achieved as a result of the proposed project are:

1. To establish a system of using regularly received remittances as a loan guarantee as well as a primary source for repayment.

2. To increase institutional and programmatic cost-effectiveness and to reduce the credit risk of lending to remittance receiving client base.





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Key characteristics of the __present situation__:

- A significant share of rural micro entrepreneurs (engaged both in farming and other activities) receive remittances from their relatives abroad
- Most of the recipients do not save the received remittances because of fragmented small amounts and cannot invest in their micro businesses
- MFIs ignore the fact of remittance receiving and lend to those who pledge valuable collaterals
- the grey box representing the overlapping groups (recipients and borrowers) is just a coincidence – a small fraction of recipients are also eligible borrowers

Key characteristics of the __situation after the project successful implementation__

- After the analysis of remittance flows, a new group of micro entrepreneurs is offered to borrow by collaterising their remittances
- Trilateral legal agreements are concluded among MTOs, lender and borrower to ensure the information sharing on remittances and, more importantly, their automatic settlement against repayments
- Existing clients are also offered to join the scheme to soften their cash flow seasonal burdens and to be eligible for bigger loans
- Both new and existing clients benefit financially, since they do not have to go to bank branches for repayments any more
- MFI benefits by broadening the base of clients and softening credit risk
- MFI also increases its cost-efficiency since now the fixed cost involved in lending to a certain region is distributed to a larger number of clients

M – rural micro entrepreneurs that express a constant demand for microcredit

R – households engaged in micro entrepreneurship that receive remittances from their husbands, children or relatives working abroad (mostly, through MTOs)

B_0 – borrowers that are eligible for MFI loans now (area in grey represents overlapping between the two currently independent groups)

B_1 – borrowers that will be eligible after the project implementation

OTHER MECHANISMS

The three "other" mechanisms are presented in the form of standard templates which contain information about the objectives of the new mechanisms, the opportunities or current gap they intend to address, the target clientele, type of organisation to potentially offer such services, type and description of the product, the proposed reasonable ranges of terms and conditions and the estimated volumes that ,after the introduction of such a mechanism, could potentially involve.

Mechanism 3. Facilitating Organisation of Family Events

a) Objective	To help remittance receivers to organise events like weddings, and to help them hedging against changing prices
b) Opportunity to address	On average, 7% of remittance income is spent on special events
c) Target clients	Remittance receivers who want to organise weddings
d) Type of organisation offering product	Bank
e) Type of product	Deposit product
f) Description of product	Client plans to organise a wedding within the next 3 years, he/she cannot afford to do it at the moment and is accumulating

	money for that purpose. Also there is a risk that in 3 years it will be hard to organise the same level of wedding due to changing prices. The bank ensures the desired level of wedding for the client independently from changing prices if remittances are deposited in the bank. The list of restaurants, hotels is defined in advance.
g) Terms and conditions	Duration is 3 years. After one year of regular accumulation of deposit (each month certain amount of remittances is deposited) client gets an opportunity to withdraw 70% of the entire amount that should have been accumulated within 3 years. If client waits for the entire period of 3 years, he/she can get 120% of the deposited amount. In case a client decides to withdraw earlier, the amount is discounted by current inflation rate. If they accumulate remittances for all 3 years, the bank organises a similar wedding at the end of the product duration, independently from price changes. Remittances are considered as a primary source of income.
h) Estimated volumes	About USD 112 million

Mechanism 4. Making Tuition Fee Requirements More Accessible

a) Objective	To help remittance receivers to pay tuition fees and make them borrow loans

b) Opportunity to address	About 24% of remittance receivers save a part of remittances for expenses on education and tuition fees, and on average, 9-10% of their remittance income was spent on education
c) Target clients	Remittance receivers who need to pay tuition fees.
d) Type of organisation offering product	Banks
e) Type of product	Mixed
f) Description of product	Client deposits from remittances fixed amounts each month, and the bank covers tuition fees independently from changes in fees. i.e. client accumulates small amounts and the bank makes lump sum payment for the client. After graduation the client is offered a loan. The list of educational institutions is defined in advance.
g) Terms and conditions	Duration is 4 years. Each month the client accumulates fixed amounts on a deposit account. The bank covers tuition fees for 4 years independently from changes in fees. After graduation the client is offered a loan for 3 years. Remittances are considered as a primary source of income.
h) Estimated volumes	USD 3.1 million

Mechanism 5. Expanding Medical Insurance Coverage

a) Objective	To help remittance receivers to buy medical insurance
b) Opportunity to address	28% of remittances receivers make savings for health care purposes, and about 9% of remittances is spent on healthcare needs.
c) Target clients	Remittance receivers who need to buy medical insurance.
d) Type of organisation offering product	Banks and credit organisations
e) Type of product	Loan
f) Description of product	Client cannot afford to make lump sum payment in order to buy medical insurance. The bank or the credit organisation buys insurance policy for the client and registers this transaction as a loan. The client, who is a remittance receiver, pays off this loan using migrant remittances.
g) Terms and conditions	Duration is 3 years. Remittances are considered as a primary source of income.
h) Estimated volumes	About USD 3.3 million

ANNEX 1. MIGRANTS SAVINGS AND INVESTMENT TRUST

Rationale for MSIT

The MSIT is anchored to the revealed specific problems with migration and economic development in the rural areas and the opportunities that the migration gives in terms of accumulation of significant amounts of money in migration.

Problems revealed

1. Migration from rural areas is extensive and endangers the economic development in the rural areas. Overall, several hundred thousand rural inhabitants are estimated to have left the country since 1991 and every 10th rural inhabitant is reckoned to be involved in labour (seasonal) migration[23].

2. Economic and business opportunities are limited, especially in non-farming segments. Rural areas lack:

i) opportunities to attract the drained workforce back

ii) workforce itself

iii) facilitating units/structures who would care about and promote the rural economic development

3. Traditional financial institutions do not actively work in the regions. Except for one bank, which lends to primary agriculture and a few small microfinance providers, other financial institutions are not interested in reaching out to the limited economic and business opportunities in the rural areas.

4. Migrants either do not trust or have no incentives to invest/deposit with traditional financial schemes in their home country, being afraid, unaware or unmotivated.

[23] Source: Radio Free Europe Caucasus Report , The CIA World Factbook, International Financial Statistical Database, Chapter 4.1.

Opportunities revealed

1. A significant share of migrants who live abroad both on a permanent or seasonal basis maintains close ties with their homes in Armenia.

2. Substantial sums of money are transferred for both saving and consumption purposes in Armenia. The amount of annual remittance flow only from Russia is estimated to reach the equivalent of one billion US dollars[24].

3. Most migrants have long term saving goals, which they achieve at a very low pace given that most of the savings are consumed.

4. Migrants wouldn't mind considering either returning ("...no opportunities though") or investing in good businesses in their communities.

5. The existing financial institutions have not paid serious attention to the migrants as a client group and their savings as a potential investment resource remain unattended.

Having deeply reviewed the problems with rural economic development, on the one hand, and revealed opportunities that the migration can bring to that development, MSIT is an attempt to partially solve the rural economic depression problem through mobilising the migrants' savings and reinvesting them into their own communities with the aim of bringing back their and their families' interest in staying and building their homes.

MSIT Strategic Objectives

The strategic objectives of the MSIT are:

- To utilise an innovative approach of attracting migrants money into their home community's economic development.

[24] Source "Survey of Households to Estimate the Real Volume of Migrant Remittances Received in 2006".implemented by Alpha Plus Consulting in 2007 and analyzed by CBA.

- To invest funds in economically lagging rural areas, where the access to traditional opportunities is very limited.
- To generate jobs among either migrants who want to return or, more likely, potential migrants, thereby decreasing their motivation to leave; who then won't go.
- To create more favorable regimes for the "first movers" – migrant groups who take advantage of the saving mobilisation schemes.
- To secure the snowball effect – through PR-ing success cases and creating "envy" with other large migrant groups

Important Constraints

- MSIT will be a well capitalised financial institution and a significant player in the Armenian financial market. It should therefore not distort the financial market by providing too concessional conditions, but rather complement the existing financial framework.
- Though donor funding will play a significant role at the outset, MSIT will aim to be financially viable in the long run: strategically, the investment and lending will be matching the funds attraction opportunities – both price-wise and term-wise.
- Though the GoA will have an important role in advising the MSIT on the most impoverished and in-need regions and communities to target, the MSIT will be an independent financial institution with high class management employed and as little government intervention as possible.
- The Armenian legislation provides a fertile soil for the establishment and operations of the MSIT, so it will be set up and operative within the existing framework in strict compliance with the local regulations.
- MSIT will in the long run aim to having a smooth exit of the donors and further incorporation/securitisation to become a fully privately owned and professionally governed financial institution.

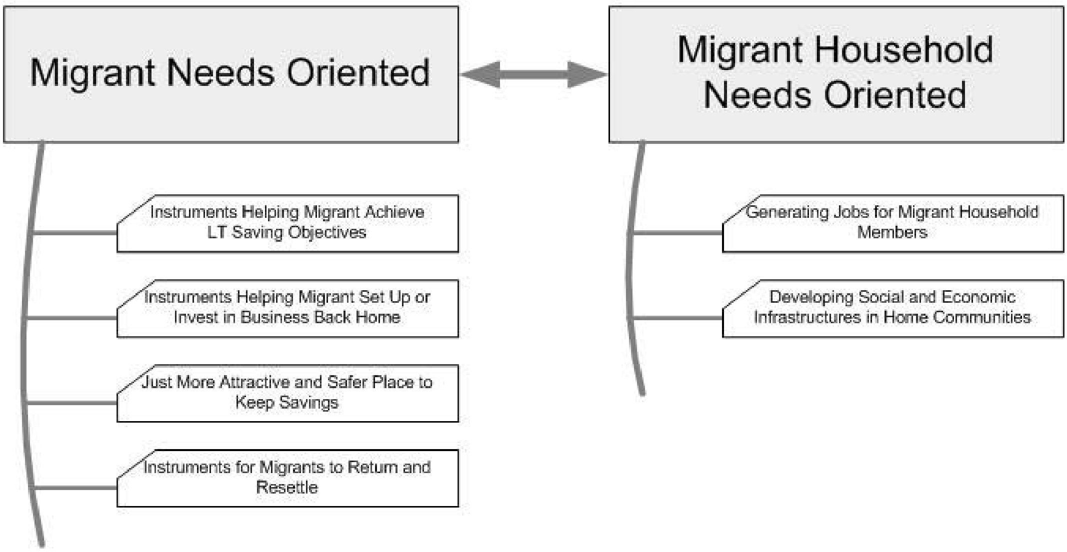
Products Offered by MSIT

Although the information on the proposed products to be offered by the MSIT to migrants and their families in rural areas is of preliminary character the main categories and core characteristics of the products will be retained, since they both comply with the present Armenian legislation and, more importantly, are based on and derive from the MSIT general goals and objectives. The products are therefore classified by their target beneficiaries (migrants vs. migrant households and home communities) and by their financial character (savings vs. investments and loans).

Classification of Products by Their Target Beneficiaries

Products offered by the MSIT will be based on its long-term objectives and will have two main directions:

- Products oriented towards needs of rural inhabitants earning money in migration (migrants' needs) and
- Products aimed at rural economic development (migrants' households needs)



Helping migrants achieve their long-term saving objectives

Even in long-term migration - needless to mention the case of seasonal, returning migration - migrants have objectives related or closely linked to their homes. Most labour migrants work abroad with a specific financially translated goal in mind – be it the marriage of the son, buying an apartment in Yerevan for the daughter and so forth. By offering the migrant to save with MSIT, the latter may then offer a long-term financing (loan) to the migrant to achieve his/her long-term saving objective much more quickly.

Instruments helping migrants set up or invest in business back home

Some migrants, especially those that have succeeded in their migration places businesswise, think of investing part of their savings (these amounts reach tens of thousands of US dollars) in their home communities. In most cases though, they have neither sufficient, reliable information about the potential business opportunities nor the time to come and make their own research and the business set up or investment. MSIT will act both as a research think tank and investment banker to offer migrants co-investment opportunities, where the MSIT and the migrants will share the risks, but prior to that, the business opportunity would have been researched and prepared for financing by MSIT.

Instruments helping migrants return and re-settle back home

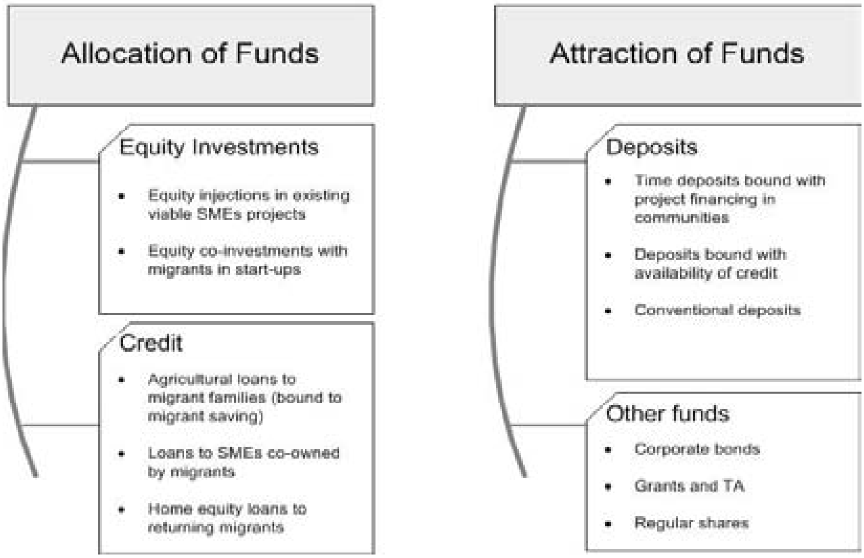
There is a constant inflow of migrants that return home after a certain period spent in migration and saved certain amounts in their pockets, albeit insufficient for serious business investments. MSIT will provide longer than presently available loans and co-investment opportunities for the returning migrants to help them establish their own micro and small-sized businesses after their return.

More attractive and safe place to keep savings

This reflects one of the key elements and objectives of MSIT – to attract the available saving resources of the migrants into their home economy. By offering the migrants deposit products that will be slightly more attractive than the market average from the financial point of view, MSIT will also link those deposits with project financing in the areas where the migrants come from, so the products will become even more attractive for the migrant to take advantage of the host country.

Classification of Products by Their Financial Character

As a regular financial institution, MSIT will be both attracting (collecting) funds and investing and lending those, based on its strategic objectives. The preliminary illustration of the potential credit, investment as well as liability products is presented below:



As it can be noted, MSIT will attempt to provide the full range of financial products to the migrants to help them achieve their objectives linked to their families and their homes, except the goals connected exclusively with the host country.

Pricing Strategy

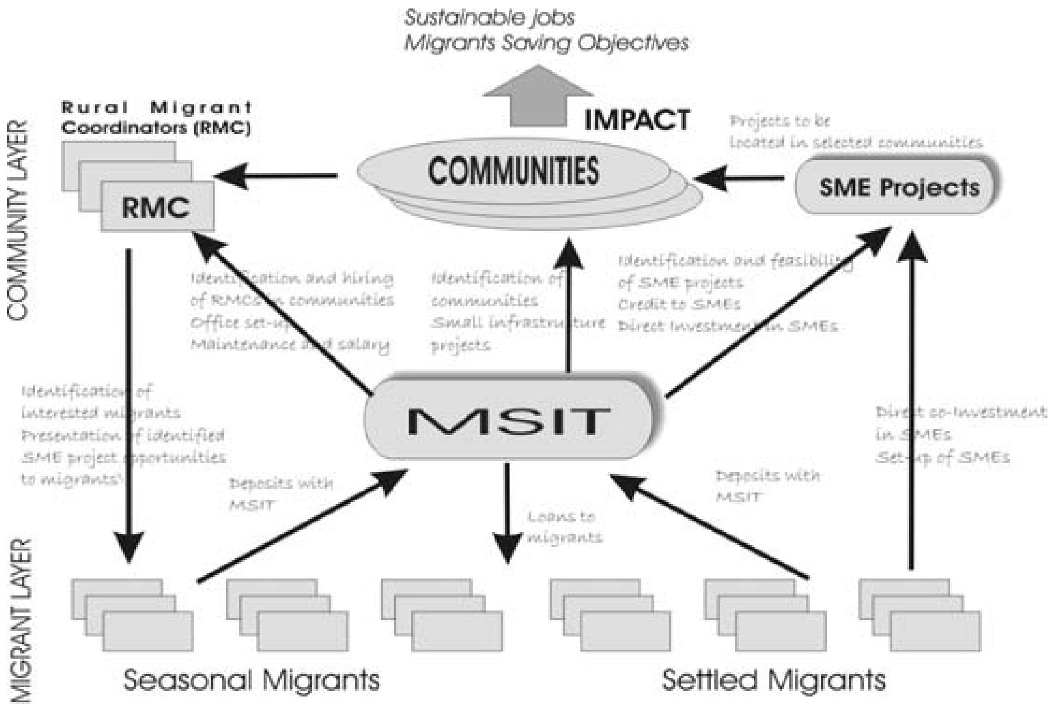
Recognising one of the most critical constraints described above, the aim is not to distort the financial market by providing too much concessional asset or too much lucrative liability products; MSIT will nevertheless stick to a prudent pricing policy aiming at providing products at least at better terms and conditions than presently offered in the Armenian market. This will be done using the optimised strategy of income and expenses, compared to the presently existing too generous spreads (mostly caused by inflated non-interest expenses in the banks.) The highly professional team of the Assets and Liabilities (A&L) department will keep the hand on the pulse thus providing the most competitive terms for migrants and their home communities.

Mechanism of Work

General Framework

A viable mechanism is proposed to be put in place thus to enable an effective (in terms of achieving its targets and objectives) and efficient (in terms of doing it at reasonable cost) and feasible implementation timeframe,. The EPC-type diagram is presented below to illustrate the main processes, directions, and activities within the proposed idea of MSIT.

T**he critical part of the economic impact of creating sustainable jobs in the communities will come from the SMEs (newly set-up or injected with fresh cash, ideas and management), which will be mainly financed by the MSIT, by both credit and equity. The SME projects, carefully identified and scrutinised by the MSIT experts, will be presented to the migrants through the hired Rural Migrant Coordinators, constantly operating and financed by the MSIT, which will be reputable people with strong influence over the compatriots, even those who have left the country several years ago. By presenting the opportunity, which would both be a lucrative source of income for the migrant and an opportunity to be of real assistance to their home communities, it also creates ground for the migrants' children to have the option to stay home when they have grown up instead of joining their parents in migration. Meanwhile, along with direct investment and co-investment opportunities, the migrants will have a chance to earn a stable income by depositing savings with MSIT and borrow from MSIT either to solve his/her long-term objectives or to re-settle.**


Sustainable jobs
Migrants Saving Objectives
IMPACT
Rural Migrant Coordinators (RMC)
COMMUNITY LAYER
RMC
COMMUNITIES
SME Projects
Projects to be located in selected communities
Identification and hiring of RMCs in communities
Office set-up
Maintenance and salary
Identification of communities
Small infrastructure projects
Identification and feasibility of SME projects
Credit to SMEs
Direct Investment in SMEs
Identification of interested migrants
Presentation of identified SME project opportunities to migrants
MSIT
Direct co-investment in SMEs
Set-up of SMEs
Deposits with MSIT
Loans to migrants
Deposits with MSIT
MIGRANT LAYER
Seasonal Migrants
Settled Migrants

Below the matrix of core activities and their respective undertakers is presented.

Core Participants	Core Activities				
	Research	**Credit**	**Investment**	**Depositing**	**Marketing**
MSIT	• Identification of target rural communities • Research of feasible SME projects to invest/lend to	• Credit to SMEs • Credit to migrants to meet their saving targets	• Investment in SME start-ups • Investment in existing SMEs		
Government	• Assistance in identification of target rural communities				
Rural Migrant Coordinators	• Finding and compiling a database of migrants (potential clients of MSIT)				• Offering revealed business opportunities to migrants
Migrants			• Co-investing in SMEs with MSIT	• Depositing with MSIT	

Key Components of Mechanism

Below we provide a brief description of the key components of the overall MSIT mechanism.

Identification of rural communities to target

MSIT will need to concentrate its activities in certain selected communities, at least in the first phase of its operations. This does not imply exclusion of any of the approximate 800 rural communities throughout the country, since practically each of them has long-term and seasonal migrants. Before the actual selection, during the test-run, the criteria for selection of those communities will be developed, the process of those communities will be tested, and the potential risk areas identified. The number of communities and the geographical coverage will grow and expand along with the successful implementation of the MSIT activities.

Rural Migrant Coordinators

MSIT will attempt to overcome the reticence of Armenians to trust financial intermediation organisations by looking to implement a targeted outreach and confidence-building strategy within the selected communities and amongst the migrants themselves. This strategy of reaching out to the migrants will be primarily based on employing a Rural Migrant Coordinator (RMC) for each potential community, whose key functions will include promotion of MSIT opportunities and products among migrants (including doing that at a distance) and their home families, identification and collection of special savings/investment needs and requirements of certain groups of migrants.

Identification of feasible projects for MSIT and migrant investment/lending

The MSIT will seek to invest in or lend to feasible projects, with concurrent co-investment from the migrants' side, preferably SMEs with labour-extensive manufacturing or service profile. Under this activity, the criteria for the project selection will be developed prior to the main phase of operation; the research will be conducted by the MSIT research arm to identify feasible projects preferably, in different regions and of different industrial profile. The result will be a formulation of brief project proposals including pre-feasibility study, financial projections, technical feasibility and recommendations on the project management. Each SME project should normally be around $50-100K in size, so the project can finance 50-70% of the project amount and the rest will be mobilised from the migrants (either in the form of loan agreement, which will be the prototype of the future deposit certificate scheme or in the form of equity co-investing). RMCs will be the bodies to channel this information about potential opportunities through to migrants.

Selecting appropriate project financing schemes

The selected projects based on the pre-feasibility studies will then have to be studied from the viewpoint of financing scheme, although there be a strict requirement to generate a more significant number of jobs in the community. Depending on the business nature, the existence of local investors, financial projections and other factors, specific approaches should be taken for each type of the selected SME projects. Special attention will be paid on the selection of the future management of the project (in case of equity investment) and the repayment capacity (in case of debt financing).

Appropriate financial schemes will be developed for the selected projects and thereafter offered to the potential migrants for co-investing.

Mobilisation of savings from migrants for the selected communities and projects

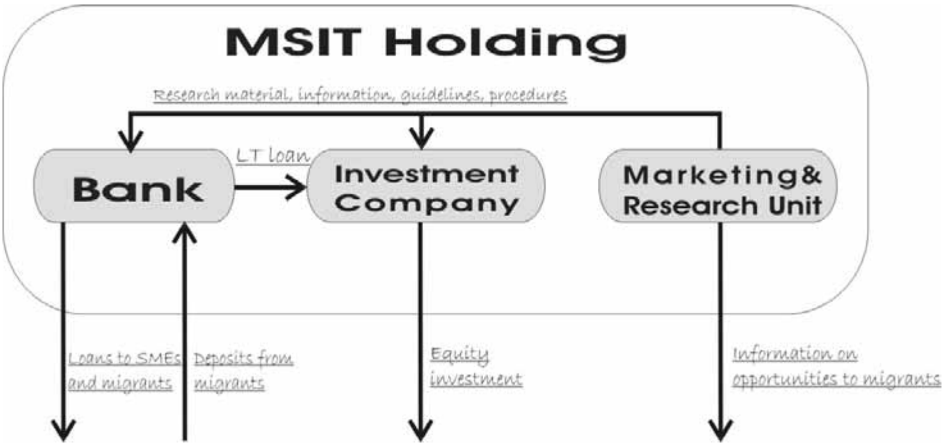
After the projects are identified, optimal financial schemes developed and put in a written form, and the RMCs are selected, the RMCs will be directly contacting migrants to present them the idea and to offer them co-sponsorship of the projects in line with the terms finance schemes developed. Though a significant potential for raising savings with MSIT, as well as a sufficient willingness to invest part of those savings back in their home communities, is revealed by the initial study, the actual preparedness of migrants to directly invest in projects in their communities or save with an institution, that will then invest in their communities, deserves to be carefully tested. Suitable adjustments will be introduced on the basis of their responses and stated concerns. Thereafter, in coordination with the selected RMC, the MSIT management will follow on contacting migrants from the communities that have expressed an interest to potentially invest in one of the SME projects.

Organisational Solution

The concept is quite ambitious – to set up a framework, which will concurrently:

- Mobilise savings (deposits) from migrants;
- Lend funds to SMEs and migrants;
- Execute direct investments;
- Do extensive research activity;
- Undertake substantial organizational and set-up works

It is proposed that under one MSIT holding, three institutions be established each targeting at one layer of critical operations of MSIT idea – credit and deposits, investment and research and marketing.



Bank

The bank is the only type of financial institution in Armenia authorised to take deposits. As deposits will be one of the key elements of mobilising migrants' resources, there is no other way but setting up a bank. Outsourcing an existing bank's services for the MSIT purposes is not recommended due to the very specific nature of the MSIT objectives and target clientele. The functions of the bank will be to lend to SMEs and to migrants, as described in the "MSIT products" section (not to invest, see further) and to attract deposits. With the minimum required capital (necessarily fully paid-up) of $5 million, the bureaucracy of setting up a bank takes 9-12 months in Armenia. Buying majority shares in one of the existing banks is not recommended at all, due to highly likely hidden burdens and heritage that such banks may have. The legal form at the first phase should be a closed joint-stock company with a 5-7 year vision of IPO (Initial Public Offering or Open Joint-Stock Company).

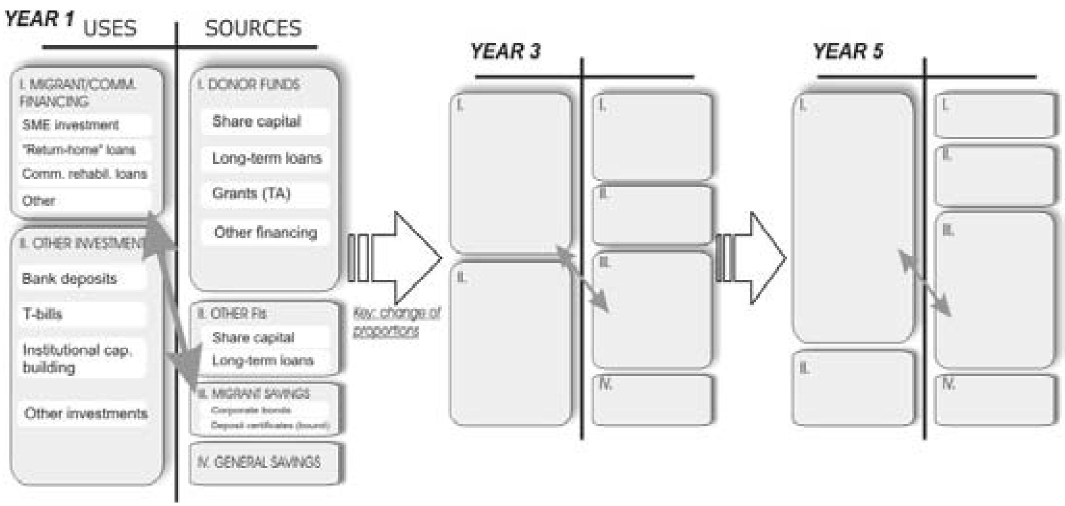
Investment Company

Since banks are prohibited to invest depositors' funds in assets of other enterprises, the equity investment function will be undertaken by the Investment Company. The funds of the Investment Company will originate from low-interest long-term loans from the MSIT Bank. In fact, the investment company will be the investment arm of the bank separately institutionalised for the legal flexibility purposes. They both will function under one umbrella of the holding and will use one strategy.

Marketing and Research Unit
This is not a financial institution. Its role will be to do the research of communities, conduct feasibility studies for the SME, perform monitoring and evaluation of all projects, develop procedures and operations guidelines, hire and control RMCs as well as establish and administer their offices, develop and implement marketing strategy and so forth.

Planning Sources and Uses of Funds

Below a consolidated picture for all three institutions (mainly, the two financial ones) is presented as far as the general distribution of sources and uses of funds goes. During the first years of operations, MSIT will be supported by donor organisations which will act as catalysts in promoting the idea and the institutionalisation of the financial instrument for migrants. Migrants' savings, respectively, will play a smaller role in the total capital at the outset. On the assets side, during the first phase, MSIT will have to allocate the funds in various existing financial instruments along with the growth of migrants and communities financing portfolio.



As one can see in the picture, the proportions will over the years change by shifting from donor financing to migrants financing (capital and liability side) and from conventional income generation from depositing and investing in existing financial instruments to lending and investing to migrants and SMEs.

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