

The international regulation of Informal Value Transfer Systems

Anand Ajay Shah*

1. Introduction

On a sunny California day, a Bengali immigrant enters an ethnic Indian grocery store in Los Angeles and greets the clerk in a familiar fashion. The immigrant hands the clerk 200 dollars he has earned as a taxi driver, and asks the clerk to arrange delivery of the money to his parents in Calcutta. Less than 24 hours later, and thousands of miles away, the funds are delivered in an equivalent rupee amount minus a small fee.

The above constructed scenario of a so called ‘hawala’ transaction can be contrasted with the description given in a *Time* magazine article less than a month after the 11th September 2001 attacks on the United States: ‘In the labyrinthine depths of old Delhi (...) men drink tea and chat in shabby offices. Nobody seems to be doing any work, until the phone rings. Then, numbers are furiously scribbled, followed by some busy dialling and whispered instruction. Although it’s far from obvious (...) these men are moving money – to exporters, drug traffickers, tax evaders, corrupt politicians. And terrorists. Welcome to the world of hawala, an international underground banking system that allows money to show up in the bank accounts or pockets of men like hijacker Mohammed Atta, without leaving any paper trail’.¹

Truth can be found in both descriptions; the real effort lays in bridging the gap between benign remittance, on the one hand, and *Time*’s more sinister picture on the other, in order to build a more complete and accurate image of *hawala*. As stated by John F. Wilson, a senior economist at the International Monetary Fund’s Middle Eastern Department, ‘for better or worse, “hawala” has gotten a bad name and it has become an issue’.²

This article will examine the ‘issue’ of Informal Value Transfer Systems (IVTS), such as hawala, from a legal point of view, assessing their vulnerability to abuse and misuse, and analysing the global recommendations and best practices which have been created to address IVTS. With a relatively nascent topic such as Informal Value Transfer Systems, and with many competing terminologies in use, it will be necessary to find out: what constitutes an IVTS, and how do different types of IVTS relate to one another? From a legal standpoint, do IVTS present enough of a threat to national governments and the international legal order to require regulation?

* The author is a *Juris Doctor* Candidate at American University Washington College of Law, Washington, DC (Utrecht School of Law, MA in International and European Legal Studies; Washington University in St. Louis, BA in Political Science and History), email: aShahTX@gmail.com

1 M. Ganguly, ‘A Banking System Built for Terrorism’, *Time Magazine*, 5 October 2001, <http://www.time.com/time/world/article/0,8599,178227,00.html>

2 J. Wilson, ‘Hawala and Other Informal Payments Systems: An Economic Perspective’, *Address at the Seminar on Current Developments in Monetary and Financial Law*, 2002, p. 1.

Since IVTS are global phenomena operating across borders, the international community has created recommendations and standards to address certain types of IVTS. What types of IVTS are these recommendation and standards aimed at, and are they adequate in addressing the problems IVTS raise?

This article will argue that international and national efforts to address IVTS only focus on certain types of older and more established forms of IVTS, and as such ignore the more modern and potentially more dangerous incarnations. Furthermore, the IVTS that are addressed at the international and national level through recommendations, standards and legal regimes are hindered by a mindset of formal financial sector regulation without fully taking into account the unique complexities of IVTS.

Part 2 will define what Informal Value Transfer Systems are, how the various methods of IVTS are carried out and whether or not IVTS constitute a threat to national governments and the global effort to combat organised crime and terrorism. These questions will be answered through a brief examination of the history, economics, mechanics and modern usage of IVTS.

Part 3 will evaluate the major international recommendations and best practices on IVTS in light of the conclusions drawn from Part 2, in order to discern the adequacy of these measures in addressing the myriad of legal, regulatory, and law enforcement challenges IVTS present. The recommendations and best practices examined will include the Abu Dhabi Declaration on Hawala, as well as various documents of the Financial Action Task Force on Money Laundering and the Asia/Pacific Group on Money Laundering. It is the aim of this article to clarify the cacophonous global discussion surrounding IVTS by defining the issue in political, economic and historical terms, and then placing this discourse within existent national and international legal regimes.

2. A survey of IVTS

2.1. *What's in a name?*

Much of the confusion surrounding IVTS is the vagueness and breadth of the terminology in use: informal remittance systems, alternative remittance systems, underground banking, unregulated banking, parallel banking, to name a few. For the purposes of this article, the term 'Informal Value Transfer Systems,' coined by Professor Nikos Passas in 1999, shall be used. Passas defines IVTS as 'any system or network of people facilitating, on a full-time or part-time basis, the transfer of value domestically or internationally outside the conventional, regulated financial institutional systems'.³ 'Value' refers to something of 'monetary or material worth'.⁴ The 'conventional or regulated financial sector,' includes banking networks, stock, commodities and bond markets, as well as official money service businesses like Western Union.

Passas amended his definition in a 2003 report jointly commissioned by the US Departments of Justice and Treasury 'to include any network or mechanism that can be used to transfer funds or value from place to place either without leaving a formal paper-trail of the entire transaction or without going through regulated financial institutions'.⁵ Passas's amended definition of Informal *Value* Transfer Systems distinguishes between two types of value: (1) the 'value' of funds (physical currency), and (2) the 'value' of non-specie items that hold or store

3 N. Passas, *Informal Value Transfer Systems and Criminal Organizations: A Study into So-called Underground Banking Systems*, 1999, p. 1 (hereinafter Passas, *Underground Banking*).

4 'Value', *Dictionary.com*, http://dictionary.reference.com/search?q=value&db=*

5 N. Passas, *Informal Value Transfer Systems, Terrorism and Money Laundering*, 2003, pp. 14-15 (hereinafter Passas, *Terrorism and Money Laundering*).

monetary or material worth (gold, clothing, machinery, stock certificates, phone cards, etc.). This article will thus refer to two types of value: (1) ‘funds,’ and (2) ‘value,’ with ‘value’ denoting non-currency items.

Additionally, the 2003 definition implicitly recognises that IVTS may interface with or use ‘formal’ financial institutions, but do so ‘without leaving a formal paper-trail of the entire transaction’. A ‘formal paper trail’ refers to standardised documentation that allows a transfer to be tracked from sender to recipient, such as is required for normal bank transfers, or formal fund transfer businesses like Western Union. ‘Entire transaction’ acknowledges that IVTS may make use of the formal financial sector for only a part of the total transaction process, and thus leave a formal paper trail for only that portion of the transaction.

Professor Passas’ 2003 report identifies the most important, but by no means only IVTS, as:⁶

Table 2.1: Types of IVTS

Hawala	Corresponding banking accounts
Hundi	Charities
Black market peso exchange Networks	Gift and money transfer services overseas via special vouchers and internet web sites (Africa and Asia)
Fei chien, door-to-door and other Asian varieties	Internet based payments/transfers
Invoice manipulation schemes	Stored value, such as pre-paid telephone cards
In-kind fund transfers (India and Elsewhere)	Debit and credit cards used by multiple individuals
Trade diversion schemes	Bank guarantee
Courier services & physical transfer	Brokerage accounts

The varieties of IVTS listed above address the difficult task facing law enforcement, regulators, law makers and the international community in identifying a given transfer as an IVTS, let alone implementing regulations designed to prevent their abuse by criminals and terrorists.

2.2. Informal Fund Transfer Systems vs. Informal Value Transfer Mechanisms

It is conceptually prudent to divide IVTS into two sub-categories: Informal Fund Transfer Systems (IFTS) and Informal Value Transfer Mechanisms (IVTM). Two points should be made. The first is semantic: while Passas’s definition of IVTS includes two types of ‘value’ (funds and value), IFTS and IVTM refer to the actual *processes* of carrying out a transfer. Secondly, IFTS and IVTM should not be viewed as static divisions; an IVTS operator may use both IFTS and IVTM.

6 *Ibid.*, p. 7.

The term IFTS was first used in a joint World Bank-International Monetary Fund (IMF) paper, which defined IFTS as financial systems existing ‘in the absence of, or parallel to, conventional banking channels’⁷. IFTS centre on fund transfer, and include ethnic IFTS (hawala, Phoe kuan, etc.), black markets for currency exchange and the physical transfer of currency or value ‘if cash is used to purchase easily moveable commodities that can later be sold’.⁸

Passas notes one of the primary characteristics of IFTS is that they are largely legitimate operations with legitimate clients.⁹ IFTS are primarily used by workers abroad to send earnings back home, and as such, the source of these funds is usually licit. To a lesser degree, IFTS are also used for payment of imported goods, or to pay for services abroad, such as education or medical care. Within this flow of mostly licit funds exist illicit proceeds of crime, as well as funds destined for the use of terrorists. It is largely because of these criminal and terrorist fund transfers through IFTS that international attention and efforts at regulation have arisen.

IVTM by contrast, refer to methods used by individuals, networks and organisations to transfer ‘both money and value informally, and for the most part illegally,’¹⁰ either through formal financial system infrastructure without detection, or by other methods and technologies that have come about in the post-Cold war globalised world.¹¹

IFTS is a ‘system’ in that it is run by operators who service the needs of their clients through the repeated and longstanding use of the same informal channels, and are usually organised into loose networks or linked by personal connections. IVTM, on the other hand, are undertaken ‘on either an ad hoc or regular basis (hence the use of the term “method” [IVTM] as opposed to “system” or “network” [IFTS]),’¹² by persons and entities who wish to avoid detection of their personal monetary or value transfers.

IVTM can be regarded ‘as mostly illegal,’ for the following reasons. Unlike IFTS the vast majority of funds and value transferred through IVTM are not the remittances of immigrant and migrant workers. Such persons only make limited use of the formal financial sector to transfer their earnings because of certain barriers of access to the formal financial system (e.g. uncertain legal status, cost), or the inability of formal financial institutions to meet their needs (cannot deliver funds to all locales). Furthermore, IVTM involve much more complicated and higher value transfers than the average immigrant or migrant worker would have the need to carry out.

Through this process of elimination it can be deduced that those who wish to use IVTM to transfer funds and value clearly have access to, and a use for, the formal financial system, yet choose not to make their transfers in a documented manner. As noted by Passas, IVTM ‘are very often part of legitimate or legitimate-looking trade transactions, which effectively obfuscate substantial value transfers,’ and ‘usually combine with other offences (e.g., tax evasion, subsidy fraud, embargo busting, capital flight, funding of militant groups, smuggling)’.¹³ It is the commission of these predicate offences that explain why IVTM users avoid straightforward formal financial sector transfers.

IVTM include all the types of IVTS not covered by the definition of IFTS, such as: in-kind payments, gifts services, invoice manipulation, trade diversion, internet-based payments, stored value, credit and debit cards used by multiple persons, correspondent bank accounts and op-

7 M. Qorchi *et al.*, ‘Informal Funds Transfer Systems: An Analysis of the Informal Hawala System’, 2003 *Joint IMF-World Bank Occasional Paper*, no. 222, <http://www.imf.org/external/pubs/nft/op/222/index.htm>

8 Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 15.

9 *Ibid.*

10 *Ibid.*, p. 16.

11 *Ibid.*, p. 22.

12 *Ibid.*, p. 16.

13 *Ibid.*

tions/futures trading.¹⁴ Perhaps most pertinent to our discussion of potential abuses of IVTS by organised criminals and terrorists: ‘IVTM have the capacity to transfer very substantial amounts of money (much higher amounts than IFTS). So, not only terrorist financiers but, even more crucially, weapons proliferators (requiring significant amounts transferred) could potentially make use of IVTMs’.¹⁵

It should be noted that many IFTS operators have adopted modern technologies in the conduct of their business, as well as the use of IVTM for settlement purposes (explained below). This trend underlines the necessity of not drawing an impervious definitional wall between IFTS and IVTM.

As stated above, recent attempts at coordinated regulation, and hence the international recommendations and best practices discussed in Part 3, pertain to IFTS, not IVTM. In the view of many authorities, ‘attempting to outlaw [or heavily regulate] IVTS ultimately deprives law enforcement of potentially valuable information and drives the informal remittance providers further “underground”’.¹⁶ This poses a greater potential problem, as, in the words of Professor Passas, ‘very little is known about IVTM vulnerabilities and serious criminal abuse (...) so regulators and policy makers run the risk of leaving the door open for more sophisticated value transfer methods that come with a higher capacity for voluminous amounts, as well as providing incentives for operators and legitimate users to turn to shady financiers’.¹⁷

This article is in full agreement that IVTS regulation should be executed in a cautious and prudent manner and that much greater analysis and research into specific types of IVTS should be undertaken. Additionally, proactive national and international efforts must be undertaken to address both IFTS *and* IVTM. If IVTM is truly the threat Professor Passas believes it to be, then the admittedly difficult issues involved in engaging the problem should not impede international attention and efforts to at least discuss the issue.

2.3. Historic IVTS

Modern IFTS are all based on the ‘two original types, namely the *hawala* (*hundi* in Pakistan), which developed in South Asia and the *fei ch’ien*, which started in China’.¹⁸ These original IFTS were created out of an economic need to transfer funds and value efficiently and safely over long distances. *Hawala* and *fei chi’en* allow their users to deposit funds with one branch of the ‘system’ located in X, and then travel hundreds of miles to Y, and collect the same amount, usually minus a fee, upon presentation of a document, password, or other instrument indicating payment was due.

2.4. Globalised IVTS

IVTS became a global enterprise with the waves of immigration from the Indian subcontinent and the Chinese mainland to other parts of the world, as these immigrant workers required mechanisms for transferring wealth created abroad back home.¹⁹ Today this not only involves

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ Secretary of the United States Department of Treasury, *A Report to the Congress in Accordance with Section 359 of the USA Patriot Act*, 2002, p. 15.

¹⁷ Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 17.

¹⁸ L. Buencamino *et al.*, ‘Informal Money Transfer Systems: Opportunities and Challenges for Development Finance’, 2002 *Discussion Paper of the United Nations Department of Economic and Social Affairs*, <http://www.un.org/esa/desa/papers/2002/esa02dp26.pdf>

¹⁹ Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 13.

South Asian and ethnic Chinese, but immigrants from every section of the ‘global south’²⁰ needing to send remittances back home.

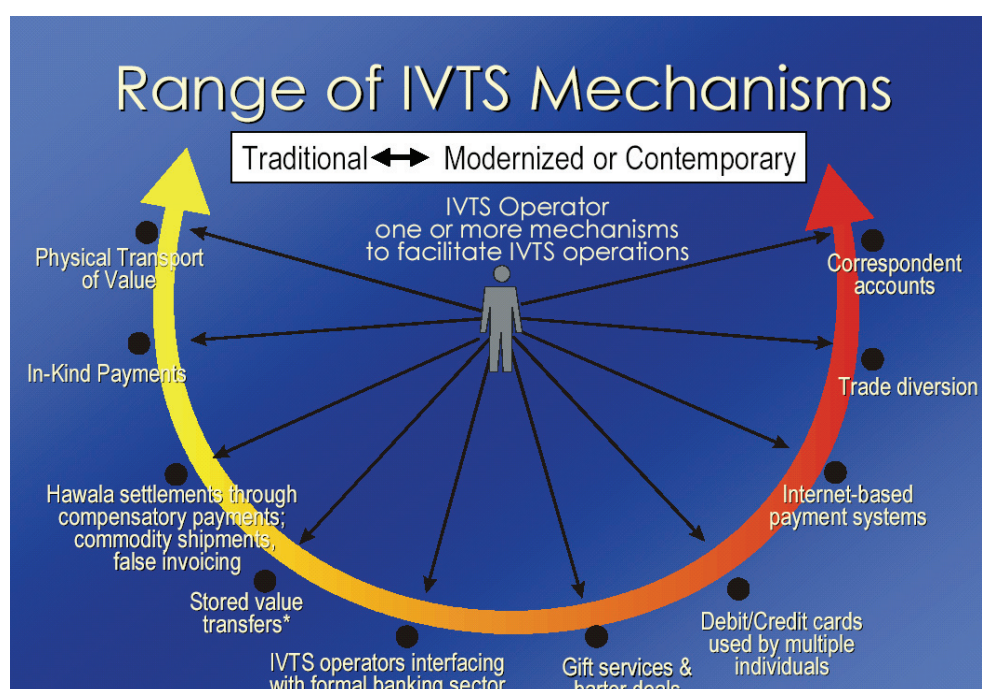
Remittances refer to ‘the portion of international migrant workers’ earnings sent back from the country of employment to the country of origin’.²¹ Remittances are divided into funds sent through regulated channels, and funds sent informally via IFTS. While exact amounts are impossible to calculate, ‘hundreds of billions of dollars are annually channelled through these IVTS’.²²

The reason IFTS are in such wide use today has to do with a variety of social, economic and political factors. As succinctly stated by the IMF’s John Wilson, ‘informal transfers are often faster, more reliable, reach more destinations, sometimes benefit from a better exchange rate and can be much cheaper than transfers through established, licensed financial institutions’.²³

Governments and international institutions have, therefore, focused on long-term macroeconomic goals targeting the financial sector (lower costs, better service, increased access), as well as economic policy (liberalised markets and foreign exchange laws) to encourage use of the formal financial sector.²⁴ This article, however, will focus on the more short-term goals of regulating a dynamic and diffuse method of value transfer that accounts in the billions of dollars, and presents unique and challenging scenarios regarding crime and terrorism.

2.5. IVTS mechanisms

Figure 2.5: IVTS mechanisms and interfaces with the formal banking sector²⁵



20 In this context ‘global south’ refers to those countries that export a relatively large amount of labour.

21 S. Puri *et al.*, ‘Migrant Worker Remittances, Micro-finance and the Informal Economy: Prospects and Issues’, 1999 *International Labour Organization, Social Finance Unit, Working Paper 21*, p. 3.

22 Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 7.

23 Wilson, *supra* note 2, p. 3.

24 Buencamino *et al.*, *supra* note 18, p. 5.

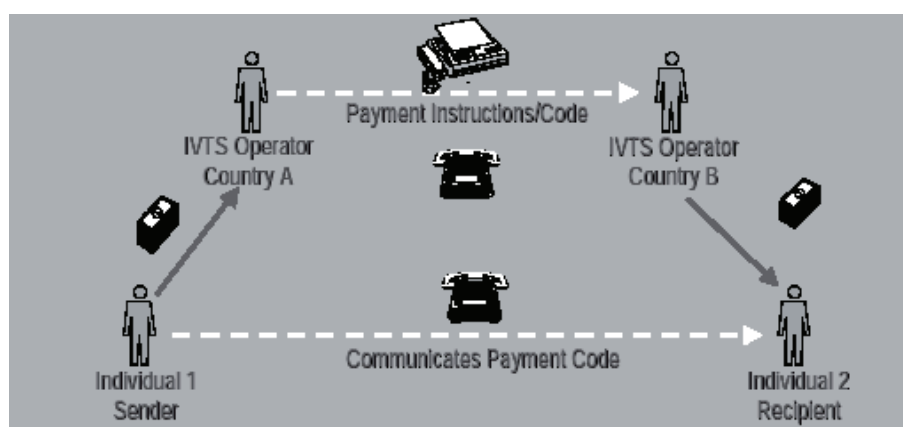
25 Taken from, Secretary of the United States Department of Treasury, *supra* note 16, p. 19.

The above chart shows some of the options available to undertake an IVTS transaction, and highlights the potential interface between various types of IVTS.

2.5.1. Ethnic IFTS mechanics

Based on the above examples of simple IFTS transactions, one broad point should be made clear on the mechanics of ethnic-based IFTS: just like formal fund transfers, money is not physically moved from one location to another to affect an IFTS transfer. In the most traditional form of an IFTS transaction, as set out in Figure 2.5.1 below, there are four key players: sender, recipient and two IFTS operators. The sender in country A will entrust his or her funds to the IFTS operator in country A. The operator in country A will then send appropriate payment instructions to the operator in country B. Meanwhile, the sender in country A will contact the recipient in country B, and tell him or her how to retrieve the sent funds (password, presentation of ID card, etc.).

*Figure 2.5.1: Traditional IVTS operation*²⁶



Since physical funds are not immediately transferred between operators, operators must draw upon ‘cash pools’ to sustain their bilateral transactions. If one extrapolates further, and assumes that country A is a labour importing country, and that country B is a labour exporting country, one can make some broad based assumptions as to how such cash pools might be sustained (see Table 2.5.1 below).

Clients on both sides of an IFTS chain provide operators with the necessary cash to service each others clients, and theoretically, to balance their debt obligations towards one another. In a conversation with a forensic account formerly employed by the Dutch police, it was related that Pakistani and Kurdish²⁷ IFTS operating out of The Netherlands handled both licit and criminal funds (drugs and human smuggling), a clear mixing of legitimate and illegitimate funds into a single cash pool.²⁸

There are, however, structural problems with this self-balancing equation: ‘it should be intuitively clear that it will be difficult and costly to settle, bilaterally, scads of positions among small operators on different continents. Thus, it is fairly well agreed that small balances are

²⁶ Taken from, United States Department of the Treasury, Financial Crimes Enforcement Network, *FinCEN Advisory: Informal Value Transfer Systems*, 2003, <http://www.fincen.gov/advis33.pdf>

²⁷ The Kurds referred to here had Turkish citizenship.

²⁸ Interview with Hans de Die, in Utrecht, the Netherlands, 21 June 2005.

“consolidated” at one or more higher levels of the hawala network’.²⁹ Furthermore, as international remittances largely flow in one direction (labour importing countries to labour exporting), it is believed that IFTS transactions in the opposite direction (cash pool B) would not be of a sufficient amount to settle accounts between IFTS operators. It is during this settlement phase of IFTS accounts that large scale criminality may enter the picture.

*Table 2.5.1: IFTS cash pools*³⁰

<i>Money and value leaving North America, Europe, Middle East, Japan ('cash pool A')</i>	<i>Money and value leaving Asia, Africa, Latin America ('cash pool B')</i>
1. Remittances of expatriates to their families	1. Families paying student tuition overseas
2. Payments for imports	2. Families covering medical expenses overseas
3. Investment funds (in case of restrictions as, for example, in India)	3. Tourists' money beyond amounts allowed by country with currency controls
4. Services provided in labour exporting countries but paid for in labour importing countries	4. Capital flight
5. Over-invoicing of exports and bogus exports	5. Payment for imports
6. Tax evasion	6. Tax evasion
7. Proceeds of criminal enterprises, such as cigarette or human smuggling, drug trafficking or any kind of fraud	7. Incorrect invoicing of trade
8. Contributions to militant and terrorist groups	8. Bribes of politicians and government officials
	9. Laundered money from criminal enterprises

2.5.2. IFTS consolidation

While the exact mechanics of IFTS debt consolidation are not fully known, Wilson notes that ‘intermediaries consolidate small positions into larger subtotals in fewer hands. Such entities (...) are larger scale operators than the small scale hawaladar (...). Where are such entities concentrated? It cannot be ascertained for certain, but for various reasons Dubai, in the United Arab Emirates, has often been singled out as a location where many hawala transactions are consolidated and cleared’.³¹ The abovementioned Dutch forensic accountant noted that London appeared to be the centre of operations between the Turkish IFTS operating out of The Netherlands (and presumably other European countries) and the other end of the IFTS chain in Kurdistan.³² Passas states that ‘there is no doubt that there are several layers of hawaladars who may play a part in the global networks’.³³

²⁹ Wilson, *supra* note 2, p. 6.

³⁰ Adapted from, Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 43.

³¹ *Ibid.*

³² De Die, *supra* note 29. ‘Kurdistan’ refers to the areas of Turkey, Northern Iraq, and Iran which ethnic Kurds claim as their homeland.

³³ Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 49.

An in-depth study was undertaken in this area by British anthropologist Dr. Roger Ballard.³⁴ He explains that within UK based South Asian communities, hawala operators exist as agents, sub-agents and sub-sub-agents.³⁵ The highest level of consolidation, ‘agents,’ ‘can be distinguished by their access to a foreign currency bank account of their own, through which hawala funds which have been collected from customers in Britain are finally routed overseas in US\$’.³⁶ Because banking commissions charged for foreign exchange become a decreasing percentage of the amount sent, ‘agents who have been granted the facilities of a foreign currency accounts (...) [may] act as patrons to a substantial number of smaller scale operators who become their sub-agents, who route their transactions through the main agent’.³⁷

Ballard further divides sub-agents into ‘those who simply collect funds from “off-the-street” customers, whose details they pass on to the higher level hawaladar,’ and ‘those who have their own relationships with overseas partners, and who use the higher-level hawaladar’s facilities solely as a means of converting cash into dollars’.³⁸ In the second scenario, known as ‘wholesale hawala,’ the path the physical currency takes in order to settle debts between an independent sub-agent and his overseas hawaladar counterpart is quite removed from the informal fund transfer itself.

Tracking an IFTS transaction and identifying the relevant parties through such a layered mechanism is a difficult proposition. Furthermore, in the chain of an IFTS transaction, the records held by any one intermediary would likely not give a complete picture of the entire transaction trail. This makes sense from the hawaladar’s point of view, as he need only know his own part in the total chain in order to successfully carry out a transaction.³⁹

2.5.3. IFTS value transfers

Value transfers also take place at the systemic level. A good example is the decades old gold buying and smuggling mechanism between the United Arab Emirates and India.⁴⁰ A hawaladar in The Netherlands (H-NL) who wishes to settle accounts with a hawaladar in India (H-I) would send the commensurate amount of money to the UAE to buy gold on Dubai’s exchange market. The gold is then smuggled into India, where demand and prices are substantially higher than the global average due to cultural significance. The gold is sold in the Indian market to settle accounts between H-I and H-NL, with additional profit made from the high market value of the commodity.

2.5.4. IVTM mechanisms

In contrast to IFTS, Informal Value Transfer Mechanisms include a variety of modern techniques to send one’s own⁴¹ funds and value anonymously. Passas lists the following as types of IVTM presently identified: in-kind payments/transfers, gift services, invoice manipulation, trade

34 See R. Ballard, *A Background Report on the Operation of Informal Value Transfer Systems (Hawala)*, 2003, <http://www.arts.manchester.ac.uk/casas/papers/pdfpapers/hawala.pdf>

35 *Ibid.*, pp. 17-18. This article uses ‘operator’ as denoting a person who provides an IFTS service. Thus, Ballard’s ‘agent’ is an operator with access to a foreign exchange account, while ‘sub-agents’ are those operators without access to a foreign exchange account.

36 Ballard, *supra* note 34, p. 17.

37 *Ibid.*, p. 18.

38 *Ibid.*

39 *Ibid.*, p. 20.

40 N. Passas, *Hawala and Other Informal Value Transfer Systems: How they Work and the Challenges they Pose*, 2002, Presentation at the 1st Conference on Hawala, p. 24, <http://centralbank.ae/pdf/Hawala2002/uae.pdf>

41 ‘Own’ refers to a personal connection with the funds or value being transferred. While it is possible for IVTM to be run like an IFTS, with operators having no personal stake in the funds being transferred, it is much more likely that IVTM are carried out by persons who have a personal link to the funds being transferred.

diversion, E-payments, stored value, credit/debit cards used by multiple individuals, use of correspondent accounts, use of brokerage accounts, options/futures trading and use of bank guarantees.⁴² It is likely there are many unidentified forms of IVTM in use today; this article will only touch on a few of the IVTM listed above.⁴³

In-kind payments are IVTM involving exchange of services or work in one country, with payment for these services made in another country.

Invoice Manipulation ‘can be used either as a method of settling imbalances among IFTS agents or employed independently as an IVTM’.⁴⁴ For example, the Kurdish IFTS previously mentioned exported goods to Kurdistan at ‘ridiculous [low] prices,’⁴⁵ a method known as ‘under invoicing,’ in order to settle accounts between operators in Europe and Kurdistan.

Trade Diversion is one of the more complicated but also lucrative forms of IVTM, with Passas noting that ‘several billions of dollars worth of diversion probably takes place each year’.⁴⁶ Trade Diversion involves two stages: the legal purchase of a good for foreign export, and the illegal diversion of the good to be sold on the domestic market where it was purchased.⁴⁷ The end result is that the purchasing company has made an illicit profit on the difference between the lower ‘foreign’ price it paid for the goods and the higher ‘domestic’ price it actually sold the goods at, as well as acquiring foreign currency held in an account outside of its home country.

Correspondent accounts held by foreign banks in jurisdictions in which they do not have a formal presence allow IVTM users to conduct what Passas calls ‘sophisticated hawala,’ which ‘moves much more substantial amounts without bank officials in the US or other countries knowing their customers’ identities.⁴⁸

2.6. IVTS, illegality, crime and terror

For organised criminals and terrorists, IVTS’ largely unregulated, under the radar, diffuse, diverse, efficient and difficult to detect nature, make them a viable option for a cornucopia of illicit activities. The capabilities existent within IFTS and IVTM to move funds and value quickly and in an undetected fashion around the globe provide ample room for abuse by organised criminals and terrorists. Traditional IFTS can be used to: pay for an illegal commodity, service, or activity, or move the proceeds of illegal activities for the purposes of money laundering.

IVTM can accomplish the same illicit goals, but lack IFTS’ systemic infrastructure, thus requiring the personal investment of individuals or organisations to undertake a particular IVTM operation. Hence, IVTM would be an unwieldy tool for certain types of illegal activities, such as individual payments by illegal immigrants to be smuggled into a country, while being particularly useful for very large transfers of funds or value.

The Appendix to Passas’s 2003 Report includes 30 case summaries of recently completed or ongoing (at the time of the report) criminal investigations in the United States and India involving IVTS operations, many of which included aspects of both IFTS and IVTM. The US IVTS cases involved:

42 Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 16.

43 For an in-depth discussion of the various types of known IVTM, see Passas, *Terrorism and Money Laundering*, *supra* note 5.

44 *Ibid.*, p. 26.

45 De Die, *supra* note 29.

46 Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 28.

47 Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 59.

48 *Ibid.*, p. 28.

- Drug smuggling;
- Embargo busting;
- Payment for the smuggling of persons;
- Money laundering;
- Black Market Peso Exchange;
- Terrorist funding;
- Credit card fraud;
- Cigarette smuggling to raise terrorist funds;
- Phone cards used to transfer drug proceeds;
- Coupon fraud linked to the cell that bombed the World Trade Center in 1993.⁴⁹

The Indian cases all involved terrorist funding. Indian authorities have long held that hawala networks are the primary source of distributing terrorist funds to Kashmiri and other terrorist organisations in Northern Indian.⁵⁰ The Dutch forensic account referenced above revealed that Kurdish and Pakistani IVTS operating out of The Netherlands dealt in both legal and illegal funds.

Professor Passas, after surveying actual IVTS investigations across the globe in his 1999 Report, identified the following as *some* real world examples of illicit IVTS use:⁵¹

- Evasion of currency controls (capital flight, etc.);
- Tax evasion;
- The purchase of illegal arms, drugs, or other illegal/controlled commodities;
- To make corrupt payments;
- Intellectual property violations;
- To receive ransom;
- To make payments for the smuggling of illegal aliens;
- To make payments for illegal trade in body parts;
- To further the commission of financial fraud;
- To finance illegal activities, such as terrorist attacks;
- To launder the proceeds of criminal activities.

2.7. The bottom line

What the above examples should make clear is that IVTS can and have been used for illegal purposes. In the 11th September world of terrorist attacks and threatened terrorist actions, leaving any channel of potential terrorist funding unaddressed would seem negligent. Furthermore, the post-Cold war globalised world that allowed the development of IVTM similarly transformed relationships between organised criminals and terrorists, forging mutually beneficial links between both groups, and even transforming some organisations into purveyors of crime and terror⁵².

Thus, addressing IVTS should be integrated into national and international initiatives to combat organised crime and terrorism. Such initiatives must, however, take into account the full realities and complexities of IVTS, which have been touched upon in this section, including

⁴⁹ Passas, *Terrorism and Money Laundering*, *supra* note 5, pp. 110-133.

⁵⁰ 'Kashmir's Hawala Scandal', *Frontline*, 23 August 1997, <http://www.hinduonnet.com/fline/fl1417/1417s001.htm>

⁵¹ Passas, *Underground Banking*, *supra* note 3, p. 37.

⁵² T. Makarenko, 'The Crime Terror Continuum: Tracing the Interplay between Transnational Crime and Terrorism', 2004 *Global Crime* 1, pp. 129-145.

IVTS mechanics, the economic significance of IVTS to immigrants and labour exporting states and the interconnection between various types of IVTS.

The international recommendations and best practices analysed in Part 3 of this article must engender a delicate balance between ensuring the viability of IFTS remittance channels, while increasing international and national capabilities to monitor their use, and counter their abuse. These recommendations and best practices do not, however, address IVTM, which Passas points out have the capability to send much larger amounts of funds and value.

IVTM are admittedly much more difficult to address because of their widely varying methods, lack of a systemic nature and their primarily criminal use. As a starting point, however, international and national legal regimes can and must address IVTM at their linkage points with IFTS in order to both fully address IFTS (transaction and settlement phases), as well as gain a better understanding of the currently very limited knowledge of IVTM use and abuse.

3. Global awareness and international standards for IVTS

In the wake of the 11th September attacks, the quiet academic approach to studying IVTS transformed into an immediate need for international cooperation on certain types of IVTS: 'At an extraordinary plenary meeting on the financing of terrorism held in Washington D.C., on 29th and 30th October 2001, the FATF expanded its mission to include terrorist financing as well as money laundering'.⁵³ The Organisation on Economic Cooperation and Development's Financial Action Task Force on Money Laundering (FATF) was the rational choice to coordinate the initial multi-jurisdictional effort to address certain types of IVTS. As noted by Nawaz, Mckinnon and Webb, 'the core policy objectives of the FATF (...) has been to improve the effectiveness of criminal justice systems, devise efficient financial system regulations and follow these with effective law enforcement in order to combat money laundering activities'.⁵⁴

Part 3 of this article examines the relevant legal recommendations and best practices made at the international level targeting particular IVTS, and evaluate such recommendations based on the background analysis of Part 2. The documentation examined will include:

- FATF 40 Recommendations (hereinafter 40 Recommendations);
- FATF Special Recommendation I: Ratification and Implementation of UN Instruments (hereinafter Special Recommendation I);
- FATF Special Recommendation V: International Cooperation (hereinafter Special Recommendation V);
- FATF Special Recommendation VI: Alternative Remittance (hereinafter Special Recommendation VI);
- FATF Interpretative Note to Special Recommendation VI (hereinafter Interpretative Note to Special Recommendation VI);
- FATF Special Recommendation VII: Wire Transfers (hereinafter Special Recommendation VII);
- FATF Interpretative Note to Special Recommendation VII (hereinafter Interpretative Note to Special Recommendation VII);

53 Asia/Pacific Group on Money Laundering, APG Typologies Working Group on Alternative Remittance and Underground Banking Systems, 'Alternative Remittance Regulation Implementation Package', 2003, http://apgml.org/frameworks/docs/8/AR&UBS%20WG%20Implementation%20Package%202003_final.pdf, (hereinafter Asia/Pacific Group).

54 R. Mckinnon, 'Informal and Formal Money Transfer Networks: Financial Service or Financial Crime?', 2002 *Journal of Money Laundering Control* 4, p. 330.

- FATF Combating the Abuse of Alternative Remittance Systems: International Best Practices (hereinafter International Best Practices);
- Asia/Pacific Group on Money Laundering, Alternative Remittance Regulation Implementation Package (hereinafter Alternative Remittance Regulation Implementation Package);
- Abu Dhabi Declaration on Hawala.

As stated above, these international recommendations and best practices are addressed mainly at IFTS, not IVTM. The terrorist funds that have been traced to IFTS operations, coupled with media reports and the post 9-11 political climate, have made IFTS the focus of national and international attention. However, as set out in Part 2, there is not a clear cut boundary between IFTS and IVTM, as an IVTS operator may engage in both types of IVTS, and a particular informal fund transfer may travel through several distinct IFTS and IVTM transfers before reaching its recipient.

Taking these particularities into account, the above recommendations and standards should address the following issues:

- Defining IFTS;
- International cooperation and coordination on IFTS;
- Ensuring the viability of IFTS for its overwhelmingly legal users and transfers;
- Monitoring of IFTS;
- Standardised record keeping;
- Regulation and monitoring of the methods involved for transfer services;
- Regulation and monitoring of the methods involved for debt settlement;
- Standardised customer policies;
- Regulation of IFTS business organisations and interconnections;
- Sanctioning of IFTS operations.

FATF's legal/supervisory approach towards IFTS regulation transposes accepted international standards and practices applicable to the formal financial sector upon Informal Fund Transfer Systems.⁵⁵ While the essential parties to an informal fund transfer remain the same: sender, recipient and IFTS operators, added to the picture are an overarching regulatory authority imposing the legal requirements of licensing or registration, customer identification, record keeping and the reporting of suspicious transactions.

With regards IFTS, which are primarily addressed by Special Recommendation VI, the FATF simply applies the accepted international standards and practices applicable to formal financial sector anti money laundering efforts to the informal sector of IFTS. Such a wholesale transfer of a legal and regulatory framework built for the formal financial sector may not be the optimal manner of addressing informal methods of fund and value transfer.

3.1. Terminology

While the definitions used in Part 2 to discuss IVTS, IFTS and IVTM were adequate in political and economic contexts, they are not uniformly appropriate for legal purposes. The Abu Dhabi Declaration on Hawala speaks of 'Hawala and other informal remittance systems,' and 'refers specifically to informal money or value transfer systems or networks outside the formal financial

⁵⁵ See S. Maimbo, *The Regulation and Supervision of Informal Remittance Systems: Emerging Oversight Strategies*, 2004, p. 4, <http://www.imf.org/external/np/leg/sem/2004/cdmfl/eng/maimbo.pdf>

sector'.⁵⁶ While this is an adequate general definition of IFTS, in order for meaningful legal discourse to take place, a more exacting definition is necessary.

The Asia/Pacific Group on Money Laundering (hereinafter 'Asia/Pacific Group'), whose Alternative Remittance Regulation Implementation Package forms the basis of the FATF International Best Practices on Alternative Remittance Systems,⁵⁷ uses the general term 'alternative remittance systems,' subdivided into two categories: 'underground banking,' and 'alternative remittance'. Underground banking is defined as 'a variety of methods through which funds (or value) are made available at a partner service in the recipient country as a result of an advice sent between the (...) operators (...). [T]he operators providing this service run ledgers which may at some stage be reconciled through movement of value between countries through a remittance, physical cash carrying, trade (including through invoice manipulation) or via commodities other than cash'.⁵⁸ This definition is an improvement over the Abu Dhabi definition of IFTS and implicitly recognises some forms of IVTM as possible settlement mechanisms for IFTS transactions.

'Alternative Remittance,' according to the Asia/Pacific Group, entails: 'remittance by alternative remittance operators of funds from clients through the regulated financial sector. These remittances are coupled with techniques designed to conceal the nature of the transaction (...)'.⁵⁹ The term 'alternative remittance' confuses the discussion, as the more generally recognised use of 'remittance' signifies the transfer of a foreign worker's income back home. While the Asia/Pacific Group's definition of 'alternative remittance' hews more closely to Passas's definition for IVTM, it refers to alternative remittance being carried out by operators, seemingly excluding IVTM transfers conducted by individuals and organisations who wish to transfer their own funds for primarily unlawful purposes.

The FATF terminological attempt uses the term 'Money or Value Transfer Service' (MVTs), which 'refers to a financial service that accepts cash, cheques, other monetary instruments or other stores of value in one location and pays a corresponding sum in cash or other form to a beneficiary in another location by means of a communication, message, transfer or through a clearing network to which the money/value transfer service belongs. Transactions performed by such services can involve one or more intermediaries and a third party final payment. A money or value transfer service may be provided by persons (natural or legal) formally through the regulated financial system or informally through non-bank financial institutions or other business entities or any other mechanism either through the regulated financial system (for example, use of bank accounts) or through a network or mechanism that operates outside the regulated system. In some jurisdictions (...) these systems have ties to particular geographic regions and are therefore described using a variety of specific terms.'⁶⁰

FATF should be given credit for creating a definition that focuses on both the actors involved in IFTS, as well as defining the activity undertaken. Using a broad definition that encompasses formal and informal services, FATF allows to slip the same regulatory glove covering the financial sector over both formal and informal purveyors of fund and value transfer. Furthermore, the FATF definition identifies both 'money' and 'value'.

56 2003 Abu Dhabi Declaration on Hawala, First International Conference on Hawala, <http://www.treasury.gov/offices/enforcement/programs/Hawala-conf.pdf>

57 Financial Action Task Force on Money Laundering (FATF), *Combating the Abuse of Alternative Remittance Systems: International Best Practices*, 2003, note 1 (hereinafter FATF, *International Best Practices*).

58 Asia/Pacific Group, *supra* note 53, p. 10.

59 *Ibid.*

60 FATF, *Interpretative Note to Special Recommendation VI: Alternative Remittance*, 2003, pp. 1-2.

Especially significant is FATF's encompassing qualification of what might constitute an informal money or value transfer: 'through non-bank financial institutions or other business entities or any other mechanism either through the regulated financial system (...) or through a network or mechanism that operates outside the regulated system'.⁶¹ However, though IVTM is implicitly acknowledged, it is only acknowledged in the context of an organised service provided by operators, as opposed to transfers conducted by individuals or organisations outside of an organised service. 'MVTs' is the closest a term has come to matching the full content of Passas' IVTS definition. The more pertinent question is how snugly the proposed regulatory/supervisory glove fits over the rather good 'Money or Value Transfer Service' definition.

3.2. IVTS global policies

Special Recommendation VI lays down that all FATF recommendations applicable to banks and non-bank financial institutions should be made applicable to MVTs, and more generally that 'each country should take measures to ensure that persons or legal entities (...) that provide a service for the transmission of money or value (...) should be licensed or registered,' and 'that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions'.⁶² Recommendation 23 of the FATF 40 Recommendations also calls for licensing or registration, and states that such businesses should be 'subject to effective systems for monitoring and ensuring compliance with national requirements to combat money laundering and terrorist financing'.⁶³ In issuing Special Recommendation VI FATF's underlying goal was to increase 'the transparency of payment flows by recommending that jurisdictions impose consistent anti-money laundering and counter terrorist financing measures on all forms of money/value transfer systems'.⁶⁴

However, within the broader framework of the 40 Recommendations and Nine Special Recommendations, FATF not only seeks international coordination, but also co-operation, a central and necessary component for addressing the international nature of IVTS. International coordination refers to the harmonisation of law and policy on IVTS among the various concerned states. International cooperation involves states affording each other 'the greatest possible measure of assistance in connection with criminal, civil enforcement and administrative investigations, inquiries and proceedings relating to the financing of terrorism, terrorist acts and terrorist organisations'.⁶⁵

In relation to international coordination, Special Recommendation I sets out that states must ratify and implement the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism, as well as act on UN Security Council Resolutions, especially Resolution 1373 on combating terrorist financing.⁶⁶ In particular, Article 18 of the UN Convention directs states to implement a variety of general measures which are essentially a codification of the more specific principles outlined in the 40 Recommendations.⁶⁷

While, the 1999 UN Convention is a treaty open to signature and ratification by all states, Security Council Resolution 1373, of 18th September 2001, is perhaps more useful due to its enactment under Chapter VII of the UN Charter. Qualifying international terrorist acts as threats

61 *Ibid.*, p. 1.

62 FATF, *Special Recommendation VI: Alternative Remittance*, 2004.

63 FATF, *40 Recommendations*, 2003.

64 Maimbo, *supra* note 55, p. 3.

65 FATF, *Special Recommendation V: International Co-operation*, 2004.

66 FATF, *Special Recommendation I: International Co-operation Ratification and Implementation of UN Instruments*, 2004.

67 1999 United Nations International Convention for the Suppression of the Financing of Terrorism, *International Legal Materials*, 1999, p. 270.

to international peace and security under Chapter VII allows the Security Council to legally obligate states to ‘prohibit their nationals or any persons and entities within their territories from making any funds, financial assets or economic resources or *financial or other related services available* (emphasis added), directly or indirectly, for the benefit of persons who commit or attempt to commit or facilitate or participate in the commission of terrorist acts (...)’.⁶⁸ Resolution 1373’s reference to ‘financial or other related services’ might certainly extend to IFTS.

When the recommendations, policies, treaties and resolutions outlined above are applied to IFTS, the multitude of legal definitions in use regarding such operations across various jurisdictions presents a hurdle that is further compounded by the fundamental legal nature of IFTS. While IFTS services are legally regulated in many jurisdictions,⁶⁹ they remain completely unregulated and unfettered in many other jurisdictions, such as states in sub-Saharan Africa, and completely illegal in still other jurisdictions, like Japan,⁷⁰ India,⁷¹ the Netherlands, France, Spain, Colombia and Saudi Arabia.⁷² Hence, to Asia/Pacific Group members India and Japan for example, Special Recommendation VI is impossible to implement, as it requires the regulation of an *unlawful* act. This is no small matter, as a country like India is a hotbed of IFTS activity.⁷³ Resolution 1337 may be a viable tool for pressuring states to address the IFTS issue: regulation if states consider IFTS legal, or strict enforcement of laws if IFTS are considered illegal.

3.3. *IVTS international*

Most labour importing countries have, after 11th September 2001, implemented some regulatory provisions for IFTS, as opposed to outlawing them. Labour importing countries that do outlaw IFTS, such as Japan and Saudi Arabia,⁷⁴ do so through strictly enforced laws governing the activities that formal financial sector institutions may undertake with regards fund transfers. Countries that do not have, or pay only lip service to IFTS related laws do so because they perceive no major economic, political, or security threat from IFTS, or do not have the resources to properly address the issue.

Finally, labour exporting countries that have banned IFTS outright do so for primarily economic reasons. Even though countries like India, Pakistan and the Philippines benefit from the billions of dollars worth of remittance that flows into their country, the nature of IFTS (recall cash pools ‘A’ and ‘B’) have macroeconomic effects that weaken a government’s ability to conduct meaningful fiscal policy.⁷⁵ Additionally, the economic delicts of capital flight, evasion of currency controls and the payment of bribes, are further reasons labour exporting countries may wish to ban or tightly restrict IFTS usage.⁷⁶ FATF recommendations are thus handicapped by the varying degrees of legality with which IFTS are regarded around the world.

68 UN Doc. S/RES/1373 (2001).

69 For example, the UK, US, Germany, Jamaica and Hong Kong all regulate IFTS operators. Passas, *Underground Banking*, *supra* note 3, pp. 53-64.

70 Asia/Pacific Group, *supra* note 53, p. 19.

71 India’s Foreign Exchange Management Act (1999) ‘prohibits informal banking networks, such as hawala,’ under penalty of civil sanctions. Interpol, *India*, 2005, p. 95, <http://www.interpol.int/Public/BioTerrorism/NationalLaws/India.pdf>

72 N. Passas, *Informal Value Transfer Systems and Criminal Activities*, 2005, p. 2.

73 The Asia/Pacific Group notes that in India ‘estimates were made in 2000 that up to 50% of the economy uses the hawala system for moving funds’. Asia/Pacific Group, *supra* note 53, p. 13.

74 Passas, *Terrorism and Money Laundering*, *supra* note 5, p. 76.

75 M. El-Qorchi, ‘Hawala’, 2002 *Finance & Development* 4, <http://www.imf.org/external/pubs/ft/fandd/2002/12/elqorchi.htm>

76 See Buencamino *et al.*, *supra* note 18.

3.4. Slipping on the regulatory glove

As set out in Special Recommendation VI, IFTS providers, whether legal or natural persons, should either be licensed or registered in order to legally operate in a given jurisdiction. This is the first step in bringing IFTS operations under the supervisory and regulatory framework of a state. The Interpretative Note to Special Recommendation VI defines the terms as follows: ‘*Licensing* means a requirement to obtain permission from a designated competent authority in order to operate a money/value transfer service legally. *Registration* (...) means a requirement to register with or declare to a designated competent authority the existence of a money/value transfer service in order for the business to operate legally.’⁷⁷ While both licensing and registration would at the very least allow the competent regulatory body to be aware of an IFTS operation in its jurisdiction, ‘the difference between the two is that licensing implies that the regulatory body has sanctioned the particular operation before it commences business, whereas registration implies that the operator has informed the regulatory body of its existence’.⁷⁸

Licensing is the optimal method of assuring persons of dubious background and intentions are not allowed legal operating status, while the more minimalist registration approach at least allows regulatory and law enforcement agencies a straightforward way of contacting IFTS operators for both specific investigations and research opportunities.

Once a jurisdiction has decided upon which (or both)⁷⁹ regulatory measure to institute, further technical considerations must be taken into account regarding how long the license/registration will be valid, whether or not a fee will be required upon licensing/registration, whether the official list of IFTS operators will be made publicly available and whether any sort of minimum capitalisation requirement will be required.

3.5. The legalisation process

Recommendation 23 of the 40 Recommendations instructs that the competent national authority should implement ‘the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a financial institution’.⁸⁰ Implementation of Recommendation 23 therefore requires a vetting process by which natural and legal persons applying for a license are evaluated under relevant criteria. The Alternative Remittance Regulation Implementation Package identifies two main areas of consideration: (1) the background of the natural or legal operator; and (2) compliance with anti-money laundering and combating the financing of terrorism measures. Legal persons who have registered with the national authority as an IFTS operator should likewise be evaluated for improper past behaviour.

A background criminal investigation of the persons registering or applying for a license would be the obvious first step in weeding out unsuitable candidates. A criminal conviction for offences associated with money laundering, or any offences related to organised crime or the funding of terrorism, should automatically disqualify a person from starting or continuing an IFTS operation. Cross checking of information across ‘appropriate law enforcement databases, including suspicious or unusual reporting filings,’⁸¹ is also advisable.

Second, ‘other offences which are specifically relevant to operating a business or financial service which may not normally be considered “serious offences” (...) such as “Failing to Keep

⁷⁷ FATF, *Interpretative Note to Special Recommendation VI*, p. 2.

⁷⁸ Asia/Pacific Group, *supra* note 53, p. 21.

⁷⁹ The United States, for example, has a dual regime of registration at the federal level, and licensing at the state level.

⁸⁰ FATF, *40 Recommendations*, *supra* note 63.

⁸¹ FATF, *International Best Practices*, *supra* note 57, p. 4.

a Proper Record” would also need to be included in the category of criminal convictions which would result in an applicant being considered not suitable’.⁸²

Special Recommendation VI further recommends that ‘agents’ of IFTS businesses should likewise be registered or licensed, and undergo similar background investigations as the IFTS business’s principles. Dr. Ballard’s study of hawala in the UK,⁸³ examined in Part 2, underlies the importance of regulating and supervising the entire transaction process.

The direct transposition of formal financial sector regulations to IFTS operations has its difficulties. Dr. Ballard paints a picture in which a ‘principle’ IFTS operator has many ‘sub-agents’ and ‘sub-sub-sub’ agents connected to the principle, some of whom may not be formally part of the business structure.⁸⁴ In such cases a legal delimitation must be made between those parties who are official agents of the ‘wholesale’ IFTS operator, and those operators who though frequent users of the wholesale IFTS operator for settlement purposes, must be legally considered an independent IFTS operator with the wholesale IFTS operator acting as a settlement intermediary.

The informal and fluid nature of IFTS necessitates a workable manner of tracking individual transfers and operators by means of consistent and efficient regulation: ‘essentially, [government] agencies need information about the customers, the transactions themselves, any suspicious behaviour, the (...) provider’s location and the accounts used’.⁸⁵

3.6. Know your customer

Customer identification requirements might very well be an area in which IFTS operators have an advantage over their formal sector counterparts. Recommendation 5 of the 40 Recommendations addresses customer identification and due diligence: ‘The customer due diligence (CDD) measures to be taken are as follows: (a) Identifying the customer and verifying that customer’s identity using reliable, independent source documents, data or information; (b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is (...); (c) Obtaining information on the purpose and intended nature of the business relationship; (d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution’s knowledge of the customer, their business and risk profile, including, where necessary, the source of funds’.⁸⁶

According to Recommendation 5, an IFTS could not legally commence a transaction unless proper identification has been shown and verified. Because the vast majority of IFTS operations operate within specific ethnic communities, logic would dictate that an IFTS operator would know much more about their clientele than the average bank officer. Case in point, the Dutch forensic accountant related that during police surveillance of a suspected Pakistani IFTS operating out of a clothing wholesaler in Amsterdam, a native Dutchman was observed as a regular customer. The Dutchman, also a clothing wholesaler, wished to avoid taxes by making payments for imported clothing through the IFTS. He had been introduced to the IFTS operator by a Pakistani wholesale colleague.

⁸² sia/Pacific Group, *supra* note 53, p. 23.

⁸³ Ballard, *supra* note 34.

⁸⁴ *Ibid.*, pp. 17-18

⁸⁵ *Ibid.*, p. 24.

⁸⁶ FATF, 40 Recommendations, *supra* note 63.

The lesson to be learned is that the same communal environment that make IFTS operations so difficult to identify and penetrate for law enforcement and regulatory purposes, also makes the identification of individual clients, their business interests, transaction habits and even personal history a much more accessible and verifiable prospect from the standpoint of the IFTS operator. The average IFTS operator will likely know his client better than the average formal sector financial institution; the real conundrum is creating a regulatory environment in which operators will willingly participate, as well as cooperate with regulatory and law enforcement agencies when necessary.

3.7. Record keeping

The record keeping of individual IFTS operators is, naturally, individual. It may be in a format that is inaccessible to anyone but the operator, as well as show only a piece of the total transaction process due to the multiple agents, intermediaries and cross connections between various types of IVTS that might be involved in a transaction. Recommendation 10 of the 40 Recommendations sets out minimum record keeping standards: ‘Maintain, for at least five years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (...) so as to provide, if necessary, evidence for prosecution of criminal activity’.⁸⁷

A five year period for record retention is an appropriate minimum time limit. All relevant information must of course ‘be available to domestic competent authorities,’ meaning the format/language of the records must be easily accessible to outside parties. As to the type of information IFTS services must at a minimum record for individual transactions in order to fulfil the requirements of Recommendation 10, the Alternative Remittance Regulation Implementation Package report suggests the following:

- ‘Name of the client requesting the transaction. Where the client is an agent for a principal, both the agent and principal’s details should be kept;
- Particulars of documentation produced to verify the client’s identity;
- Contact details of the client;
- Date of the transaction;
- Amount and currency of the transaction;
- Name and identifying details of the recipient;
- Location to where the funds should be remitted including full account details if the funds are to be remitted to an account;
- Details of the account used by the alternative remittance operator to process the transaction’.⁸⁸

The purpose of such record keeping is to allow regulators and law enforcement to track a transaction from sender to recipient. However, while a hawaladar in California will likely know his local sender or recipient client fairly well, ‘in the process of receiving funds for onwards transmission from another operator to another intermediary or the ultimate recipient, operators are reliant upon the transmitting remittance operator to conduct the appropriate know your customer checks. In order for a meaningful audit trail to be in place, the operator should obtain

⁸⁷ *Ibid.*

⁸⁸ Asia/Pacific Group, *supra* note 53, p. 26.

all details of the ultimate recipient from the transmitting remittance operator and should keep those records'.⁸⁹

FATF Special Recommendation VII is designed to address this issue: 'Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address, and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain. Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information'.⁹⁰

This is perhaps the point at which the relationship between regulatory requirements and an operator's burden are at their most tenuous. As noted by Dr. Ballard, a transaction may originate at the 'sub-agent,' or the 'sub-sub-agent' level,⁹¹ while Special Recommendation VII does not mention attaching agent information to the transaction. This may prove vital, as an investigation tracking an international transaction to its source may end at a large hawaladar who employs multiple layers of agents. Each agent may have his own sub-agents, who in turn have a few specific clients. It needs to be readily apparent who in the IFTS chain actually had contact with the client.

The FATF definition of MVTs, as discussed above, seems to envision the use of IVTM: 'or any other mechanism either through the regulated financial system (...) or through a network or mechanism that operates outside the regulated system'. Thus, an IFTS operator who uses IVTM for a particular transaction would be legally required to attach the same attendant information as he would to a 'normal' IFTS transaction.

There are, unsurprisingly, some hurdles to this otherwise flexible solution. First, national government limitations on what businesses are legally designated MVTs or IFTS (a gold trader, an operator using e-payment?) may legally exclude from an IFTS network transaction nodes that have been longstanding parts of the system, thereby forcing operators to either change their patterns, or allow transactions to become unrecorded at this point in the network. The problem is exacerbated at the international level, with certain types of IVTS transactions considered legal in some jurisdictions, and illegal in others. There will also be difficulties from a standardisation viewpoint, as the multitude of possible IFTS and IVTM combinations within a given transaction would make for a potentially convoluted trail: for example: Sender → Operator 1, basic hawala → Operator 2, gold value transfer → Operator 3, e-payment → Operator 4, courier → Recipient. How such a transaction recording scheme would work in practice, over multiple jurisdictions, remains to be seen. The recommendation is however, a genuine attempt to address the complexities present in IVTS transactions. The most glaring deficiency of FATF and other international recommendations and best practices are their failure to address the settlement side of IFTS. This issue shall be discussed in the following section on banks.

3.8. The role of banks

In Part 2 the variety of ways in which the formal financial sector integrates with IVTS was examined. The most common example is that of cash pools 'A' & 'B,' in which an IFTS operator who also runs a primary business, like a grocery store, makes deposits into a business bank account from the proceeds of both his or her primary business as well as his IFTS operation.

⁸⁹ *Ibid.*, p. 27.

⁹⁰ FATF, *Special Recommendations on Terrorist Financing*, 2004, p. 2.

⁹¹ Ballard, *supra* note 34, p. 18.

Another situation might involve an IFTS depositing both legal remittances and the proceeds of criminal activities or terrorist funds into the same account. In either example funds are commingled, muddying the true source of the deposited funds.

The FATF International Best Practices advises that an IFTS operator be required to, ‘maintain the name and address of any depository institution with which the operator maintains a transaction account for the purpose of the MVT service business. These accounts must be capable of being identified and should be held in the name of the registered/licensed entity so that the accounts and the register or list of licensed entities can be easily cross-referenced’.⁹²

Thus, an IFTS operator choosing to use a depository account in the course of its operations must use such an account exclusively for IFTS purposes. Also, the account should be directly associated with the IFTS business. Implementation of this recommendation should make the commingling of licit (remittances) and illicit (proceeds of crime, terror) funds more difficult to carry out so long as record keeping and customer identification practices are also adhered to and enforced.

3.9. Settlement

The other use of bank facilities by IFTS operators has to do with the settlement process. The 40 Recommendations and Nine Special Recommendations are largely silent on the issue of the IFTS settlement process, only mentioning the use of bank accounts briefly in the FATF International Best Practices.⁹³ As explained in Part 2, a straightforward settlement scenario would entail funds in an IFTS operator’s account accumulating to a certain level, after which a wire transfer is sent to an overseas account held by the IFTS operator’s counterpart, thus settling the debts for the funds paid out by the counterpart at the request of the originating IFTS operator.

The average IFTS operator, however, dealing with transfers of a relatively small value, and with various overseas operators, will not undertake individual overseas wire transfers himself. Dr. Ballard explains that in the South Asian IFTS operating in the UK, a high level of consolidation is present, in which the higher level hawaladars amalgamate the debts of lower level operators.⁹⁴ In such large transactions, made up of countless individual transactions, the prospect of mixing licit and illicit funds becomes very real.

The 40 Recommendations and Nine Special Recommendations do not directly address IFTS settlement processes by means of the formal banking sector, as such transfers would fall under the wider ambit of the 40 Recommendations provisions on bank transactions. Recommendation 11 of the 40 Recommendations states: ‘Financial institutions should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities and auditors’.⁹⁵

A two part division can be made here: either the IFTS operator (more likely a ‘wholesale’ operator) has associated the account with his IFTS business as set out in the FATF International Best Practices, or the account is not registered as an IFTS account. If the account is not registered as an IFTS account then a bank, in order to make a good faith effort at implementing Recommendation 11, would have to undertake a preliminary investigation as outlined above.

⁹² FATF, *International Best Practices*, *supra* note 58, p. 4.

⁹³ *Ibid.*

⁹⁴ Ballard, *supra* note 34, p. 18.

⁹⁵ FATF, *40 Recommendations*, *supra* note 63.

FATF has issued a ‘Guidance for Financial Institutions in Detecting Terrorist Financing’,⁹⁶ many provisions of which are applicable to ferreting out undeclared IFTS accounts. The Alternative Remittance Regulation Implementation Package also identifies some key characteristics of bank accounts being used for an IFTS operation:

- Large sum deposits and withdrawals, some of which may be in cash;
- Account used as a temporary repository;
- A high number of transactions but a comparatively low average balance;
- Frequent international funds transfer instructions;
- Multiple transactions below threshold for cash handling related bank charges;
- Frequent no book transactions;
- Deposits made at a variety of branches, which can be concentrated near border crossing points;
- Depositors reluctant to reveal identity or appear to be acting upon instruction;
- Many different depositors;
- Account holder sometimes has no knowledge of the depositor;
- Balance of the account is frequently checked;
- Accumulation of funds prior to large outward remittance. Frequent transactions with other known money service businesses;
- Outward remittances to recipients who apparently have no business / personal relationship with the account holder.⁹⁷

The above criteria are, however, only valuable for identifying unregistered IFTS accounts. If the account is legally registered as associated with an IFTS, there appear no additional efforts outside of the general FATF recommendations dealing with bank accounts and wire transfers to regulate such IFTS accounts. While records of each IFTS transaction must be kept under Recommendation 10 of the 40 Recommendations, such requirements do not extend to the settlement of accounts. As explored in Part 2, settlement processes between counterpart IFTS operators can be carried out through innumerable mechanisms, direct bank transfers being one such option. As related in Dr Ballard’s report, ‘wholesale’ hawaladars collect the debts of countless smaller level hawala operators who do not have access to foreign exchange accounts, for purposes of eventual settlement at the global level.⁹⁸ The prospect for abuse by the commingling of licit and illicit funds certainly exists, especially as the value and complexity of consolidation increases.

From a legal standpoint, as settlement of accounts is distinct from the fund transfer process, it is debatable whether or not an IVTS operator is actually an ‘operator’ for the settlement portion of the relationship. This is even more so an issue in the case of IFTS wholesalers who will likely have no connection to the initial IVTS transaction, but are simply consolidating the debts such transactions have created for settlement at higher levels.

While terms like the Asia/Pacific Group’s ‘underground banking’ may include settlement as a definitional aspect, legal-based definitions like FATF’s ‘Money and Value Transfer System’ are centred on a service being provided. Any IFTS transaction made up of clients and operators would certainly consist of a service; a settlement transaction on the other hand takes place in the context of a business relationship between partners, not as a service provided to the public. Upon

⁹⁶ FATF, *Guidance for Financial Institutions in Detecting Terrorist Financing*, 2002.

⁹⁷ Asia/Pacific Group, *supra* note 53, pp. 33-34.

⁹⁸ Ballard, *supra* note 34, p. 18.

a closer examination of the MVTs definition however, a ‘wholesale hawaladar’ might very well be construed as providing a ‘service’ to lower level operators: in essence an IFTS for IFTS operators. While this does not appear to be the intent of the MVTs definition, it might still provide the basis upon which to apply record-keeping and transaction reporting requirements to IFTS settlement and consolidation operations.

In order to track such large amounts of consolidated funds, as well as to better regulate and understand the settlement process, it is advisable that an additional level of record keeping be implemented to address IFTS settlement. Such a proposal would not prove unduly burdensome because settlement transactions are by nature larger payments that take place in a time frame of weeks if not months, as opposed to the daily pace of individual IFTS transactions.

Such record keeping would allow the international regulatory framework to address both columns of the IFTS business model. Settlement books could thereby be compared with outgoing client transactions in order to detect numerical discrepancies. Additionally the knowledge gained by instituting such a requirement would prove invaluable in forging a better understanding of IFTS mechanics, as well as flesh out the web of connections between various operators from the local and national level, to the global, allowing for a better fitting regulatory glove.

3.10. Transaction reporting

Arguably the most important part of the regulatory framework for both the formal financial sector, as well as informal value and fund transfer systems is the identification and reporting of suspicious transactions. Recommendation 13 of the 40 Recommendations states: ‘If a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, directly by law or regulation, to report promptly its suspicions to the financial intelligence unit’.⁹⁹

However, the fact that a certain transaction is suspected as consisting of proceeds from criminal activities or destined for terrorist use does not, in and of itself, necessitate suspension of the transaction under the 40 Recommendations. Under Recommendation 5 of the 40 Recommendations, if a transaction is deemed suspicious by an IFTS it must conduct appropriate customer due diligence. If any part of the customer due diligence checklist cannot be verified, especially when concerning the purpose and intended nature of the transaction, the transaction cannot proceed. Thus, while not explicitly stated by the 40 Recommendations, suspicious transactions *must* be reported, and *may* be suspended.

The FATF ‘Guidance for Financial Institutions in Detecting Terrorist Financing’ is a starting point upon which national regulatory authorities can advise IFTS operators on how to detect suspicious activity. The added advantage that IFTS operators have over the formal financial sector is their familiarity with the majority of their clients. Any significant changes in a client’s activity would immediately be noticed, and should entail further investigation, and if necessary, a report to the appropriate governmental authority.

With regards to the role of IFTS operators as intermediaries, Special Recommendation VII states that: ‘Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information’. Thus, any missing information from a transaction record forwarded with a transaction request should entail immediate investigation, and reporting to the governmental authorities if appropriate.

⁹⁹ FATF, 40 Recommendations, *supra* note 63.

3.11. Compliance and monitoring

3.11.1. International

Compliance at the international level must also be discussed, as the critical components of international coordination and cooperation are the basis of any proposed global IFTS regime. Recommendation 37 of the FATF 40 Recommendations states that: ‘Where dual criminality is required for mutual legal assistance or extradition, that requirement should be deemed to be satisfied regardless of whether both countries place the offence within the same category of offence or denominate the offence by the same terminology, provided that both countries criminalise the conduct underlying the offence’.¹⁰⁰

The recommendation satisfactorily addresses differences in criminal law when both countries recognise the underlying legality of IFTS, but does nothing to address the legal disconnect between states that recognise IFTS operations as legitimate, and those states that completely outlaw IFTS operations. Only a frank acknowledgement of legal and policy differences between countries on opposite sides of the IFTS debate will allow common ground to be forged upon which mutual legal, regulatory and law enforcement assistance can be rendered.

3.11.2. National

At the national level, once a regulatory framework has been put in place violators must be identified whether they are operating without a license or registration, improperly following regulatory provisions, or knowingly participating in the transfer of terrorist funds and or money laundering activities. The FATF International Best Practices suggest that regulatory agencies should have the legal authority to investigate ‘underground’ IFTS operations, audit licensed or registered IFTS operations for compliance with national legislation, as well as identify and more closely monitor those IFTS operators that are of a higher risk of being a conduit for terrorist funds or money laundering.¹⁰¹

The authority to make scheduled checks and unauthorised visits of registered IFTS operators should be a basic power granted to the regulatory authority under the registration regime in order to assure compliance with relevant regulations. The identification and classifying of ‘high risk’ operators would necessitate regulatory agencies analysing all relevant information they have gained on registered entities through the registration process and on-site inspections, and assess such information in light of the specific circumstances concerning terrorist financing and money laundering in their jurisdiction.

Additionally, ‘systems should be established which would bring any conviction of an operator, shareholder, or director [of an IFTS]), to the attention of the appropriate authorities’.¹⁰² Convictions of agents working for an IFTS should also be taken into account if related to the financing of terrorism, money laundering and its predicate offences, or financial crime related offences.

3.12. Sanctions

Sanctions for violations of national legislation are set out in Recommendation 17 of the 40 Recommendations: ‘Countries should ensure that effective, proportionate and dissuasive sanctions, whether criminal, civil or administrative, are available to deal with natural or legal

¹⁰⁰ *Ibid.*

¹⁰¹ FATF, *International Best Practices*, *supra* note 58, p. 8.

¹⁰² Asia/Pacific Group, *supra* note 53, p. 30.

persons covered by these Recommendations that fail to comply with anti-money laundering or terrorist financing requirements'.¹⁰³

As the international regulations and standards discussed take a relatively light approach (velvet glove, not leather) to the regulation and supervision of IFTS businesses, this must be counterbalanced by relatively harsh sanctions for violation of laws and non-compliance with warnings, in order to assure respect and adherence for the regulatory regime. However, an appropriate grace period should be allowed in order to inform, consult with and instruct an informal industry that has been largely insulated from concerted government intervention and oversight.

3.13. Implementation

In the end, the international recommendations and best practices explored above must be implemented across a multitude of jurisdictions around the world while still upholding an international framework within which the truly global and cross border issue of IVTS can be addressed. However, we have already seen that important states in the IVTS debate, such as India, currently remain outside the regulatory discussion for mainly (and not unjustified) macroeconomic and political/security (corruption, funding militants) reasons. Therefore, states regulating and supervising certain types of IVTS must find common ground with states like India in order to minimise the difficulties posed by the varying legal status of IVTS.

4. Conclusion

As stated in the introduction to Part 3, FATF was the proper forum within which to begin the initial global effort to address IFTS in the wake of the 9/11 attacks. The four-part FATF regulatory framework for IFTS, when interpreted through the lens of 'Money and Value Transfer Service,' does address many of the problematic issues raised by IFTS.

However, such a direct transposition of guidelines built for anti-money laundering purposes in the formal financial sector cannot be expected to perfectly fit the unique characteristics of IFTS. First, the overarching need of the FATF regime to place IFTS within a wider definition that includes formal financial sector businesses (Money and Value Transfer Service) only exacerbates the ability of regulatory agencies to identify and tailor policies to IFTS.

Another failure of the FATF regime is ignoring countries that choose to outlaw IFTS, as opposed to implementing the regulatory scheme urged by FATF. The FATF 40 Recommendations or an addition to Special Recommendation VI should include additional guidance on undertaking mutual legal assistance with states that outlaw IFTS. FATF, its associated regional organisations, or perhaps a new international body should serve as a neutral financial intelligence clearinghouse for information sharing on IFTS between all states, regardless of whether they regulate or outlaw IFTS. The goal of such an organisation should be to minimise the damage caused to international cooperation by states that outlaw IFTS, and therefore are not able to collect the same type of domestic intelligence on IFTS as regulating states.

The fact that IFTS settlement is not addressed by the 40 Recommendations and Nine Special Recommendations is a further indication of an ill-fitting transposition of formal financial sector regulations onto the informal sector. A comprehensive regulatory regime must address the

¹⁰³ FATF, *40 Recommendations*, *supra* note 63.

settlement side of IFTS transactions, as they are equally susceptible to abuse, especially in regards to money laundering.

Finally, the FATF regime barely attempts to address IVTM. While the fact that IVTM are usually undertaken for criminal purposes makes regulation of such transactions a moot point, states must at least begin discussions on international cooperation and coordination for combating IVTM, just as they have started the discussion on IFTS.