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# INFORMAL VALUE TRANSFER SYSTEMS, TERRORISM AND MONEY LAUNDERING

A REPORT TO THE NATIONAL INSTITUTE OF JUSTICE

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## FOREWORD

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Before the terrorist attacks of September 11, 2001, the Financial Crimes Enforcement Network (FinCEN) was interested in conducting a study into the risk posed to this country by informal methods of money transfers. I was contacted by the Office of Strategic Analysis, and we had preliminary discussions about the project. Because the terrorists were from countries in which informal payment methods are prevalent the project took on a new urgency, particularly as the US Congress showed a strong interest in hawala. So, the current project was initiated in October 2001 with the objective of establishing the facts on these methods, the use (actual or potential) by legitimate clients as well as terrorists and other criminal actors, the modus operandi observed and anticipated in the near future, and concluding with concrete recommendations for law enforcement agencies and policy/law makers.

As principal investigator, I underwent a background investigation, which was completed towards the end of January 2002. This delayed, by a few months, access to law-enforcement agencies and sensitive data, but it eventually enabled the interaction with prosecutors and investigators working on active cases. This led to a mutual assistance process, whereby I assisted in interpreting events and transactions, while obtaining valuable insights on current cases and possibly illegal operations. I was also given access to Suspicious Activity Reports (SARs), which I reviewed in order to ferret out instances which merit further investigation by law enforcement around the country.

In the meantime, a partnership was established between FinCEN and the National Institute of Justice (NIJ), allowing for considerable expansion of this study's scope by incorporating data from other countries. This resulted in a substantial amount of valuable information from the UK, Pakistan, India, Afghanistan, the UAE, Somalia, Yemen, Netherlands, Greece, Italy, Germany, Australia and elsewhere as well as a spectacular increase in international contacts offering to assist in the project. While this embarrassment of riches is welcome, it has caused a time- and financial-resource strain because we had to decide what avenues to pursue and which ones to leave for another day.

Because of the mutation of the initial study into a FinCEN-NIJ joint project and the late start of the NIJ funding (end of May 2002), it was agreed that the final report would be a joint publication by the two departments (Treasury and Justice) when the research for the NIJ part is completed (end of August 2003).

Another development during the course of this study was the creation within FinCEN of a new unit, the Non-Traditional Methodologies Section. I was immediately contacted by the new team, to coordinate our efforts and integrate approaches. This process has been highly successful, and I would like to thank particularly Michael Rosenberg (head of the unit) and Sam Meale (Senior Adviser), along with Kevin Bleckley and Robert Long, for their extraordinary contributions, support and collegiality. Together, we established a large informational infrastructure that continues to produce waves of significant case materials and other information from around the country. I participated in the team's outreach program with trips to Washington, DC, New York City and Chicago, making further contacts and opening up new research horizons. I assisted in the interpretation of evidence and prosecutorial efforts in several cases, while I prepared and presented several seminars with US agencies and representatives of foreign Financial Intelligence Units (FIUs).

Further, I also worked very closely with FinCEN/NTMS and helped produce a report to the US Congress on "Hawala and Related Informal Value Transfer Systems

Vulnerabilities, Law Enforcement and Regulatory Challenges, and Recommendations’, as mandated by the Patriot Act 2001 (the official title is “Report to Congress in Accordance with Section 359 of the USA Patriot Act”): <http://www.fincen.gov/hawalarptfinal11222002.pdf>.

There are too many interviewees to name here and thank for their valuable assistance, openness and time they made to share their views and knowledge both in the US and in many other countries. NIJ rules do not allow the naming of interviewees, but they all know how grateful I am.

The project benefited from the hard work of several research assistants, particularly Cynthia Medina, Dr. Hildrun Passas, Dr. Divya Sharma, Janelle Tufts and Jenny Young.

NIJ’s Lois Mock has been a wonderful and generous supervisor of this project. I would like to express my deep appreciation for her dedicated efforts, the time she has made and warm support.

In addition to the amazing support provided by FinCEN and its Non-Traditional Methodologies Section, my research has been supported by assistants and colleagues coming from India, Pakistan, China, Puerto Rico, Germany, Greece, Russia, Canada and the USA, who also drew on their personal and direct experiences on IVTS.

Finally, I received from NIJ a supplementary amount of \$20,000 to expand the scope of the present study and look into trade-based value transfers and misconduct using data from the US Customs and Border Protection and a Washington, D.C. law firm. This part of the research is continuing with new funding from NIJ. The main focus is on precious metals and stones, tobacco and alcohol.

## SUMMARY OF SIGNIFICANT RESULTS AND POLICY IMPLICATIONS

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Although hawala, as a method of informal value transfer, was the initial point of interest after 9/11, a wide range of methods and networks operate in similar ways and perform analogous services or functions. That is, funds and value transfers from place to place on behalf of legal actors, terrorists or other criminal groups take place informally or without leaving many obvious traces (or at all) I call these processes Informal Value Transfer Systems (IVTS) (Passas, 1999). The most important IVTS identified so far are:

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

The first point to underline is that hundreds of billions of dollars are annually channeled through these IVTS. If we include the correspondent account method (which is not informal as it is conducted through recognized international banking systems, however, there is no knowledge of the customers recorded in the US and the purpose of the transfer or the ultimate recipient are unknown to US and respondent banks), the total volume rises to trillions of dollars. Hence,

- IVTS cannot be ignored for policy purposes.

It is important to stress the finding that there is extensive cross-ethnic collaboration legitimate and criminal value transfers (including funds destined for the support of terrorist groups). The previously held view that these are family-based and

exclusively ethnic networks is unsupported by our data. In addition, the success and efficiency of traditional IVTS like hawala have inspired imitators outside Asia (e.g. Nigerians or Surinamese). In this light,

- Focusing on one IVTS or ethnic group is not only seen by those affected as discriminatory (with its own negative consequences), but also misses the point and opens up opportunities for terrorists or any criminals to take advantage of inattention of certain routes or networks for easier and undetected value transfers.

Traditional IVTS like hawala, hundi and fei chien are very old and ingrained in the culture of many ethnic groups. They also serve many legitimate needs. This makes it unrealistic to try to stop or eliminate them. Some countries have tried, but achieved nothing but criminalization of otherwise law-abiding members of society. Indeed, such attempts are likely to backfire and produce negative effects on US interests here and abroad. For this reason:

- Attempts to over-regulate or regulate without understanding their inner workings cannot be expected to work.
- Attempts to regulate without the consensus and input of insiders (operators, users and intermediaries) will simply violate the element of trust that is one of their defining and time-abiding elements.
- Attempts to regulate strictly without the above will simply drive the IVTS underground (much more than they are now), will provide incentives for secrecy and better organization, participation (given the higher premium that can then be charged), and resistance to authority in general. Such attempts may also generate ill will and discontent with the US government.
- This points to the need for an outreach and consultation/awareness program (similar to what FinCEN undertook with mainstream money service businesses in the past). Compliance and collaboration with IVTS operators and users is likely to be enhanced. This result would be invaluable as the US seeks to gather information on terrorist groups and prevent any attacks on US interests. In other words, the findings so far seem to lend support to the view that allowing IVTS to operate and try to enlist them in the effort to root out terrorist activities and groups is much more productive than attempting to impose regulations on actors that will resist them and become alienated.

To facilitate law enforcement and regulatory actions in the relatively unfamiliar field of IVTS, three items are produced in this report. First, an analysis of difficulties likely to be encountered in investigations of hawala transactions in contrast with anticipated difficulties in investigations of any transnational type of misconduct. The point is to show what is specific about hawala and how it impacts regulatory actions.

Second, a distinction is drawn between informal funds transfer systems (IFTS) and informal value transfer methods (IVTM). Both are within the wider category of IVTS, but the latter almost always involves crimes and other misconduct, whereas the former are primarily serving legitimate customers. In this way, controllers would know whenever they detect an IVTM operation, crimes were very likely committed. On the other hand, when they detect an IFTS operation, they should not automatically assume crimes are committed.

Third, two sets of indicators are developed regarding the operation of IFTS. One is indicators of IFTS activity. In such cases, if the US operators are not registered and licensed, as required, they would be committing an offense. Otherwise, the operations/transfers probably do not involve other crimes. The second set of indicators flags criminal abuse of IFTS. When one or several of them obtain in a given case, the situation would merit investigation to find out what types of funds are transferred and for what purposes. IVTS do interface with a wide range of criminal transnational activities. Therefore:

- Understanding IVTS requires a better understanding of transnational crime, an understudied area thus far.
- Studying IVTS more in depth can contribute to a better understanding of transnational crime.

To a very large extent, traditional forms of IVTS serve legitimate needs that cannot be met in other ways. It would be wise therefore to:

- Explore ways of offering additional channels for fund transfers;
- Ensure continuation of vital services and minimum disruption;
- Improve institutional or official methods offering similar services;
- Reduce economic and other criminogenic asymmetries.

IVTS include an extremely wide range of methods from very low tech and simplistic to highly sophisticated; we also see the interface of several of them, including cross-ethnic collaborations. Terrorism funding can and has come from all of the above channels. It is essential, thus, to consider,

- that paying attention only to hawala-type operations is misplaced and ineffective;
- the need for inclusive, comprehensive policy based on an adequate understanding of interfaces;
- focusing on the most significant, rather than excluding from policy considerations methods like trade diversion; and,
- engaging in more in depth studies of each method with the view of training officials for better detection and separation of legal use from suspicious and criminal abuses.

As pressure often mounts to take swift action, we need to calculate as precisely as possible the anticipated consequences of policy and measures of anti-terrorism or other initiatives, so that we can:

- ensure international cooperation of law enforcement and other authorities is improved (seminars, training, awareness for domestic and foreign organizations);
- ensure law enforcement requests for assistance are based on facts, not on flimsy and uncorroborated evidence;
- ensure US law enforcement agencies assist in the work of overseas counterparts as reciprocity is indispensable for long term successes.

On a different level, given strategies related to the financing of terrorism cannot solve all problems, we need to fully understand and fight the roots of terrorism and other serious crime problems. Supply-side approaches only have a limited and rather short-term effect. Demand-side policies hold a stronger promise for a safer planet and protection of US interests.

- Given the ease with which serious transnational crime occurs, it would be cost-effective to better understand the causes and facilitating circumstances of these crimes and construct policies aimed at tackling the root of the problem. Criminal policy is only an immediate term solution, but offers little hope of effectively dealing with the problem in the long run.

## INTRODUCTION

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For many years, representatives of national, foreign, and international law enforcement agencies have been concerned about the role played by Informal Value Transfer Systems (IVTS) in the facilitation of serious crimes, including money laundering. Terrorism is now at the top of the list.

Understanding IVTS is crucial because they originated and are widely practiced in countries from where terrorism suspects came or operated – i.e., in the Arab/Muslim world and the Middle East, as well as other parts of Asia. IVTS include various ethnic traditions or practices, such as hawala, hundi, padala, fei chien, Phoe kuan, and the black market peso exchange. Most of them have also been referred to as ‘underground banking systems’ or ‘alternative remittance systems’.

Previous work revealed that hawala has been used to finance terrorist activities IN South Asia (Passas, 1999, 2000). More importantly, reports and official statements in the aftermath of the September 11 attacks suggest the Taliban and Al-Qaeda networks may have made use of IVTS. For this reason, on November 7, 2001 at FinCEN’s office, the President of the United States, accompanied by the heads of the Departments of Justice, Treasury and State, declared hawala and other types of IVTS need to be placed under the microscope to stop any terrorism or other crime-related flows of funds.

Passas introduced the term IVTS to refer to “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” (Passas, 1999).

Despite earlier calls for research and better information on IVTS, very little original and systematic work was done on this subject until now (APG, 2001). Unfortunately, current literature on the subject is not only lacking depth, but is also replete with inconsistencies and inaccurate information. A previous study sponsored by the Research Unit of the Dutch Ministry of Justice, which included original material and a review of public-source information and reports (e.g., reports issued by the Commonwealth Secretariat [1998], the DEA [1994], the Financial Action Task Force [1997, 1999, 2001], and the US State Department [1997], etc.) revealed that information

was sparse and often completely unreliable (Passas, 1999). Exaggerations and contradictions were found within single documents undermining their credibility. The fact that erroneous or de-contextualized information found its way into academic and policy writings is cause for concern. “Facts by repetition” (i.e., repeated inaccuracies that produce an illusion of validity) contribute to the creation of false conventional wisdom. Interviews with officials from different continents demonstrated significant differences of opinion. Equally distinguished and well-intentioned people offered diametrically opposite assessments of the IVTS issue. Moreover, some interviewees questioned directly the validity of certain official reports, which are mostly based on arrests and specific cases (Passas, 1999, 2000). At the same time, that study established that criminal organizations do use IVTS. Offenses committed include the following: evasion of currency controls (capital flight, etc.); tax evasion; the purchase of illegal arms, drugs, or other illegal/controlled commodities; 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 militant/terrorist activities; and to launder the proceeds of crime. All of these findings have been confirmed by subsequent reports (APG, 2000, 2001; Howlett, 2001).

Another gap in the literature relates to the social organization of serious crime in general (Baker and Faulkner, 1993; National Research Council, 1999). As international efforts are underway to disrupt the financing of terrorist groups, it is essential to understand the basic methods of operation, social organization and beneficiaries of various types of IVTS by drawing on the experience and knowledge of controllers and other people with direct contacts with operators in various countries, with especial emphasis on bin Laden or al Qaeda sympathizers. Once an infrastructure for the illicit or secret cross-border transfers of funds, goods or people is built, we should expect that it may be used for other purposes, including support of terror.

For this reason, this NIJ/FinCEN study into IVTS and its connection with criminals, particularly terrorist groups, is timely and urgently needed. The study started by looking into US-based evidence and law-enforcement sensitive documents. However, a lot of material and data are scattered around the world in police or other files.

Controllers in Asian, European and African countries investigated the criminal use of

IVTS, but their knowledge and needs are neither pieced together nor understood. Existing files are not always properly analysed to establish how typical or exceptional instances are and what policy adjustments may be required. For this reason, this study adopts an international approach and attempts to assemble the various pieces of the jigsaw puzzle.

Toward that end, systematically collecting and examining evidence from countries where hard data are available and fuel official concerns that IVTS are an important money-laundering or financial crime vehicle is essential. In this way, the US reality can be analyzed against the international background and context in which IVTS operate. Cases affecting the USA or involving American participants (beneficiaries, victims and facilitators) do in fact emerge for the first time from evidence residing abroad.

The principal goal is to focus on the social organization, modus operandi and growth of IVTS in several Asian, European and African countries with ethnic populations =resorting to IVTS. This study sheds new light and offers insight into the variations of IVTS, the way they interface with both legal and criminal actors, the volume of money that goes through them, the extent of abuse by terrorists, and the ways in which law enforcement can respond most effectively by drawing on the experience and lessons gained in jurisdictions that actively fought IVTS for many years.

The main emphasis is placed on hawala and trade diversion, for these were viewed as the highest priority and controllers were least familiar with them. As the study progressed and new forms of IVTS were detected, brief outlines and scenarios are provided, but these are essentially areas beyond the scope of the present study. Some of them will be the subject of further research in the coming two years. With respect to trade diversion and commodity-based value transfers, this is effectively an interim report noting basic modi operandi, recording findings up to date and indicating areas for further study.

## **DEFINITIONS**

The term IVTS was coined to de-mystify and describe more accurately what used to be called “underground banking” or “alternative remittance systems”. Both terms are

inaccurate and misleading in their attempt to describe hawala-type transfer systems. Banking was rarely, if ever, involved in these transactions, which took place quite openly in many parts of the globe<sup>1</sup>. The word ‘alternative’ is also not well chosen because it implies the existence of other, mainstream or conventional, remittance systems. This is clearly not the case in scores of regions in the global South, where IVTS with a variety of names but quite similar mechanics have operated for very long time, pre-dating contemporary banking facilities, which remain inaccessible to millions of people in many countries. “Alternative”, thus, is too ethnocentric a term to apply in this context.

“IVTS” was originally coined for hawala and fei ch’ien (flying money), the Chinese equivalent of South Asian systems. Yet, it was soon found that other ethnic groups and regions are associated with various currency black markets some of which are characterized by very similar mechanics (e.g., the black market peso exchange [BMPE] or the Nigerian Naira markets). In other words, there are additional IVTS not anticipated by the original project. The current project initially employed the term for all kinds of traditional ethnic systems for sending and receiving funds or value across regions. However, a closer look into the processes by which operators settled their accounts revealed additional methods and means often interfacing with more modern and Western trade and financial institutions. One important finding of this study is that IVTS are not confined to the methods and networks we set out to study. Quite sophisticated and complex transactions were employed not only for settlement purposes, but also as separate and stand-alone value transfer methods, such as invoice manipulation or the informal use of correspondent bank accounts. Common among them are the trust on which transactions are based and the ability to leave no traces for anyone seeking to reconstruct the trail of the value/funds.

The contemporary practice of hawala itself involves frequent interfaces with banks and other financial institutions. In order to be more precise, therefore, the IVTS definition should be amended slightly to include any network or mechanism that can be

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<sup>1</sup> Only in Yemen have IVTS operators been found to engage in lending, investment and deposit-taking practices (Ross and Cohen, 1981); in Somalia credit services have been offered in the past without charge by informal remittance agents to local recipients of regular payments from overseas (ILO Mission, 1999; Omer, 2002).

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.

As attention was brought to hawala and other ethnic IVTS after the 9-11 attacks, law enforcement frequently requested guidance as to whether all such operations are per se related to terrorism or other crimes. In response to this demand, the development of guidelines and indicators of abuse became a priority, so no effort is wasted on legitimate transactions,. The indicators will be discussed in subsequent sections, but it was important to clarify the terms used and to specify what kind of methods of money or other value transfers they involve.

Thus, two types of IVTS can be usefully distinguished. The first is informal funds transfer systems (IFTS) (this term has been used in World Bank and IMF studies as an alternative to hawala; see Maimbo, 2003; el Qorchi et al., 2003) and the other is informal value transfer methods (IVTM). IFTS have the following main features:

- They constitute traditional ethnic fund and value transfer operations and businesses. They originated in the Indian sub-continent and in China, but spread throughout the globe following waves of immigration and processes of economic globalization;
- They are currently subject to regulations designed for so-called ‘money service businesses’; and,
- Their clients and services are for the most part legitimate (even though they are, just like any other businesses, open to abuse for crime facilitation)

Examples of IFTS are physical transport methods (e.g., self-carry and courier services), hawala, hundi, fei chien, padala, phoe kuan, hui k'uan, ch'iao hui, nging sing kek. These names reflect the ethnic and national origins of the providers and users of the systems, some of which pre-date the emergence of modern banking and other financial institutions. The black market for Colombian pesos and other currencies also fall under this category. It is noteworthy that, contrary to some writings, transactions through money changers and brokers, who offer better than official (and most often controlled) exchange rates, did not originate for money laundering or other serious criminal offenses (James et al., 1997; Passas, 1999).

On the other hand, there are networks and organizations, which employ methods of transferring both money and value informally and, for the most part, illegally. IVTM share the following main characteristics:

- They do not require the existence of widespread networks of people; most of them can be accomplished by a couple of individuals on either an ad hoc or regular basis (hence the use of the term ‘method’ as opposed to ‘system’ or network’);
- They involve the use of the formal financial system, but they leave no trail for anyone wishing to monitor or reconstruct the route of a transaction intended to remain secret;
- They are very often part of legitimate or legitimate-looking trade transactions, which effectively obfuscate substantial value transfers;
- They are always criminal and usually combine with other offenses (e.g., tax evasion, subsidy fraud, embargo busting, capital flight, funding of militant groups, smuggling);
- They 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.

Examples of IVTM include

- In-kind payments/transfers
- Gifts services
- Invoice manipulation
- Trade diversion
- E-payments (internet based payments/transfers)
- Stored value (e.g., hundi, chits, pre-paid telephone or credit cards, bearer instruments)
- Credit/debit cards used by multiple individuals
- Use of correspondent accounts
- Use of brokerage accounts
- Options/futures trading
- Use of bank guarantees

Neither of the above lists is exhaustive, but they include all varieties identified so far. The various IVTMs will be described in some detail later on, but at this point it is important to note that the IFTS-IVTM distinction is not just academic. It highlights the large variety of channels that can be used for serious misconduct, many of which involve

regulated and formal sectors or institutions. The task of introducing effective regulation, therefore, is more complicated than one might think.

More importantly, however, another point is that authorities are currently attempting to regulate and render more transparent IFTS (under whatever terms they use; e.g. money service businesses or MSB). These efforts at regulation are taking place with a sense of urgency in the aftermath of terrorist attacks (Maimbo and Passas, 2004). To the extent these efforts are not well thought out and accepted by the participants, a shift towards the use of IVTM may be anticipated. The problem is that 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 such shady financiers. In other words, insensitive or unsuccessful regulatory frameworks can result in a criminalizing effect for people and funds that are absolutely legitimate. Ironically, thus, instead of increasing transparency of fund transfers and reducing crime, the authorities' efforts may produce precisely the opposite result. In addition, blocking the channels of legitimate and desperately needed remittances in needy parts of the planet victimizes and alienates large numbers of people.

It is worth bearing in mind that despite some claims made in the press about informal methods used by the 9-11 hijackers to transfer their funds, all available evidence points to the use of banks, wire services, credit card accounts and regulated remitters. In many other instances of terrorism (e.g. in the Middle East, South Asia and Africa), militants have indeed used IFTS for at least some of their fund transfers. It is also true that the small amounts needed for suicide missions can be transferred through both regulated and IFTS channels without raising eyebrows. So, while some funding of terrorism does occur through IFTS, there is little reason to believe that: a) these would be necessarily or invariably the militants' preferred method, or b) IFTS are more vulnerable to abuse than the regulated sector.

In conclusion, there is no need for an express route to regulation of IFTS. In light of the risks generated by careless attempts at regulation, a cautious and thoughtful approach appropriate in various contexts is strongly recommended (Maimbo and Passas, 2004).

## **METHODS**

Diverse methods were employed in this study. In addition to a sweeping literature review of academic, official studies, policy and media writings, the main focus has been on generating primary data by searching and collecting legal case material in countries with IVTS activity or connections. As this study was undertaken in partnership with FinCEN, access to sensitive law enforcement information was available. Such information cannot be disclosed or cited in this report. However, volumes of evidence relative to numerous cases in several states informed the thinking and the writing of this report. So, the case data include both active investigations (in the US and the UK) and closed cases.

The aim was to collect a comparatively large sample of cases and to conduct a series of case studies highlighting the diverse mechanisms and networks of IVTS. In depth interviews were conducted with law enforcement agents (both high level and line investigators pursuing IVTS cases), prosecutors, regulators, academics in other countries looking into money laundering, representatives of non-governmental organizations, international organizations, and policy makers.

The underlying questions asked during the unstructured interviews with officials were:

- How significant is the IVTS in your country in terms of amounts of money that go through these channels?
- Who are the main participants and beneficiaries?
- How often do they use IVTS?
- Why do they resort to IVTS?
- What alternatives to IVTS are there for them?
- What types of crimes are committed through IVTS in your knowledge?
- What is the typical modus operandi in your country?
- What less typical methods have you also seen in your country or elsewhere?
- Have terrorist groups been involved in fund raising or transfers through IVTS?
- How have you been able to detect IVTS operations?
- What legal or regulatory problems have you been facing?
- What reforms/measures would assist you in detecting IVTS and enforcing the laws in place?

- What is the official and legal/institutional response to IVTS-related issues in your country? Any reforms being debated or planned? What is the time frame for implementation?
- What control practices seem to work best in your or other jurisdictions you are familiar with?
- Have anti-IVTS measures in place (if any) been evaluated for their effectiveness?
- Have criminals adapted to successful law enforcement operations against IVTS or other financial institutions?
- What is the future threat as you can imagine it?
- What regional and international measures or mechanisms are necessary as far as you are concerned?
- On what experience or cases have based your responses to the above questions?

Interviewees rarely had answers to all those questions, while a lot had indirect knowledge and, occasionally, admitted that hearsay was the source of their information. It emerged that, even in countries with long traditions and a great deal of experience in hawala, a significant degree of inaccuracy or ignorance could be found among controllers. As a result of repeated meetings, confidence and trust was established with many of them, which increased my ability to get sincere responses to my queries and use the most solid information. As part of this process, in the end, this author was invited to present some preliminary findings at ad hoc seminars or lectures for law enforcement in places like India, Hong Kong, Greece, United Kingdom, Germany and Italy. Invariably, offers to share findings with local officers resulted in additional and high quality case data they were willing to provide.

Critical is that these views are supplemented by interviews with operators and users of IVTS in the US and overseas. These interviews were very informal and lasted from a few minutes to several hours each. In all instances, the interviewees were made aware of this project and its objectives. None of the interviews could be recorded and no formal protocol was used due to the informality of the whole context. This was the only way in which participants in this very informal and trust-reliant environment would agree to speak about the mechanics of IVTS and their roles in it.

Notes were made after these meetings and comments were added to drafts prepared earlier on the social organization of IVTS, especially hawala, which was the main starting point of this study. The cumulative notes and details produced the following section on the mechanics and settlement processes in hawala.

To recap, the materials drawn upon include:

- Interviews with hawaladars, other IVTS operators, money changers and their clients from the UAE, Pakistan, Sri Lanka, Iran, Iraq, Kurdistan, Afghanistan, Turkey, Somalia, Nigeria, Kenya, Senegal, Colombia, USA, S. America, Germany and Greece.
- Unpublished, partially published and non-public reports by the International Monetary Fund and the World Bank, the Asia-Pacific Group Typologies Working Group on Alternative Remittance & Underground Banking Systems, and regulatory and control agencies in the US, India, Pakistan, France, Germany, Australia, the Netherlands, Greece, Italy, and the United Kingdom.
- Published reports by government and non-governmental institutions
- Dozens of legal cases involving the abuse of traditional IVTS in the UK, US, UAE, Australia, India, Pakistan, the Netherlands, Canada and other countries.
- Academic literature on IVTS and transnational crime, with which IVTS often interface.
- Interviews with academics, lawyers, regulators, prosecutors and law enforcement personnel in the US, UK, Germany, Italy, Greece, the Netherlands, India, Pakistan, the United Arab Emirates, Australia, Malaysia and Hong Kong.
- Interviews with officials and researchers of the International Monetary Fund, the World Bank, Interpol and the United Nations Monitoring Group (regarding sanctions on Afghanistan).

Notable is that thousands of internet pages inundated cyberspace in the aftermath of September 11. Unfortunately, the overwhelming majority of them contain distorted and misleading information. The diversity of the sources of information allowed us to transcend any single perspective and view.

The data are organized and analyzed in a way that will be most useful for a) public policy construction, b) legislative or administrative measures that may be required, and c) for the assistance and training of law enforcement agents at all levels, so that they can identify and target illegally operating IVTS in the USA and overseas.

Most documentary evidence available was converted into text files and entered into a database to be catalogued, coded and analyzed through “atlas.ti”, a software program for qualitative research. This allowed the records to be easily accessed,

systematically organized and analyzed. The coding scheme evolved in the course of the study and is still elaborated as the research into different types of IVTS continues.

## **A GENERAL OVERVIEW: DIFFERENT TYPES OF IVTS**

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While hawala was originally the main focus of the study, two facts became obvious early on. Firstly, it is by no means the only or main IVTS through which substantial amounts can be transferred. Secondly, hawala networks themselves often involve multiple intermediaries each of whom employs different methods and financial facilities. These methods range from the simple use of banks for deposits and wire transfers to complex trade arrangements and the use of modern technology. In addition, a host of other methods, through partially regulated channels, effectively operate in the same way and offer similar services as hawala. That is, money and value transfers from place to place on behalf of legal actors, terrorists or other criminal groups are taking place informally and/or without leaving traces for investigators through correspondent bank accounts or the internet.

For this reason, an analytical distinction was made between IFTS and IVTM. IFTS are for the most part much older and rooted in the culture of several ethnic groups. IVTM, by contrast, emerged with the introduction of the internet and sophisticated technologies as well as in the context of globalization and the end of the Cold War, all of which affected trade patterns and financial practices. In many instances, IFTS adapted to the new reality and opportunities by diversifying tools and instruments for settlement, while preserving most of the essential mechanics. In other words, there have been cases where IFTS and IVTM combined.

Instead of thinking too rigidly in terms of “boxed” categories of IVTS, the empirical reality points to a range of IVTS as a continuum from traditional *modi operandi* to completely contemporary IVTMs. Many current and actual cases reviewed constitute a mix of methods and networks. While there are some major themes and analytical distinctions to be drawn, the variations seem to be quite frequent in reality.

Figure 1 below illustrates this host of methods and networks operating in similar ways, performing similar services, interfacing with each other, and ranging from the low-technological ones to most sophisticated.

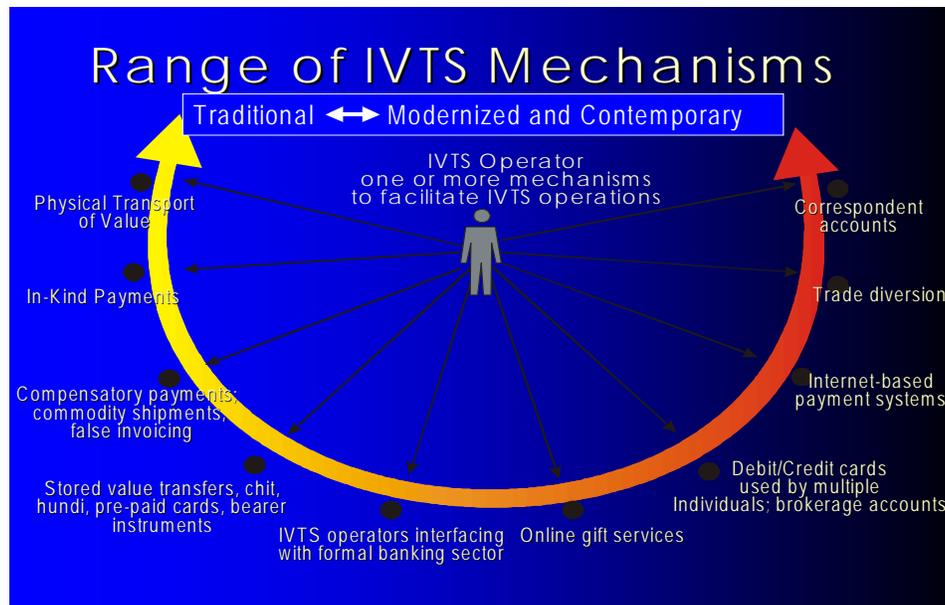
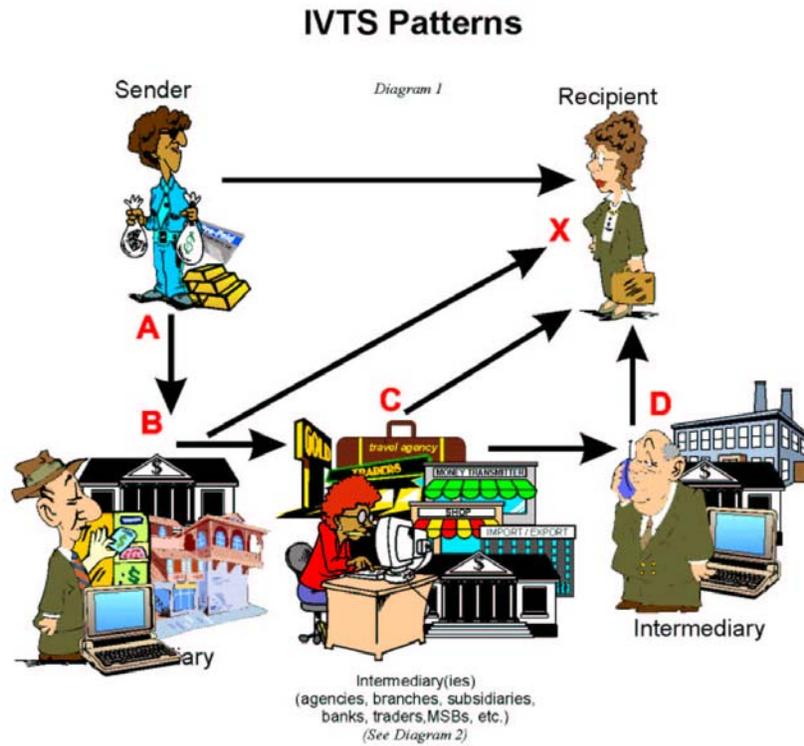


Figure 1: Range of IVTS Mechanisms: From the Most Traditional to the Most Sophisticated.

Because of the anonymity and secrecy afforded by all of these methods, most have been used for the laundering of tainted money, the payment of bribes or alien smuggling fees, drug trafficking, gun running, and terrorist funding in many parts of the world. It must be impressed that not only can these methods be used by the same operator, but various operators can also interact in the settlement process and use their own preferred method.

It was because of the possible nexus to terrorist funding that some IVTS, most notably hawala,—came to the attention of the drafters of the Patriot Act of 2001. Yet, there is a need for law enforcement and regulatory authorities to be aware individually of each IVTS as well as the extensive and potentially complex nature of interfaces among several IVTS (see Figure 2 below as well as more detailed discussions in the following section).



### Basic Mechanics of IVTS

1. **A-X** (physical transport; in-kind payment; pre-paid telephone cards and stored value)
2. **A-B-X** (courier, e-payment, credit and debit card use)
3. **A-B-C-X** (Hawala and other traditional IVTS; wire remitters, in-kind payment; gifts and vouchers)
4. **A-B-C-D-X** (trade diversion; correspondent banking; BMPE; mixed IVTS, including sophisticated hawala)

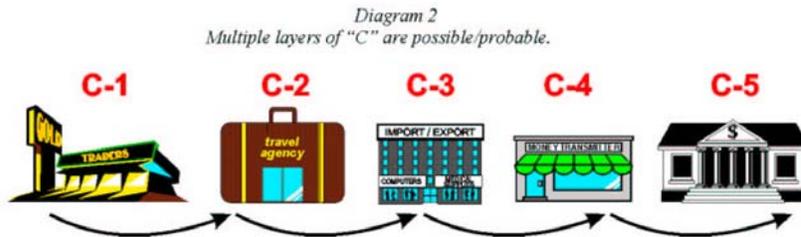


Figure 2. Main Patterns of IVTS

## IFTS

Courier services and physical transport methods are nothing new. We find that whenever trust is absent or fees too high, both legal and criminal actors physically move cash on their own, hand it to trusted friends and relatives or resort to part-time and full-time couriers. Cash has been discovered transiting in anything from containers to suitcases. Couriers are also used by money changers in the Middle East, who trade in currencies and therefore need the cash in place. Value can also be couriered, if cash is used to purchase easily movable commodities that can later be sold and their value encashed (e.g., gold or jewelry).

Another practice that can be used independently or as a settlement method involves the provision of services or in-kind payments. A travel agent in the US, for instance, routinely sends groups of tourists to India, where all their costs are already covered (food, drinks, excursions, accommodation, etc.) The travel agent receives the payment in dollars but keeps it here. Someone who wishes to send money to the US from India actually pays for all these expenses once the tourist groups are in the country and requests that the travel agent deposit that amount in a US account he controls directly or through a nominee (e.g., a false-name or “benami” – also spelt “bainame” – account). If the provider of the tourist services happens to be a hawaladar also, then this is a way for them to settle up. People may also provide services or work in one country in order to pay off a debt they have in another.

Additionally, there is a family of traditional IFTS with different names depending on geographic location and ethnic group. Following is a sample of the most common terms:

- Hawala (it means “transfer” in Arabic and “reference” in Hindu) – India, United Arab Emirates (UAE), and the Middle East
- Hundi (akin to a bill of exchange or promissory note; it comes from a Sanskrit root meaning “to collect”) - Pakistan, Bangladesh
- Fei ch'ien (flying money) - Chinese
- Phoe kuan - Thailand
- Hui k'uan (to remit sums of money) - Mandarin Chinese

- Ch'iao hui (overseas remittance) - Mandarin Chinese
- Nging sing kek (money letter shop) - Tae Chew and Cantonese speaking groups
- Chop shop - foreigners use this term for one of the Chinese methods
- Chiti banking – (refers to the "chit" used as receipt or proof of claim in transactions introduced by the British in China; short for "chitty", a word borrowed from the Hindi "chitthi", signifying a mark).
- Hui or hui kuan (association) - Vietnamese living in Australia
- Door to door, padala – Philippines
- Black market currency exchange – South America, Nigeria, Iran
- Stash house (for casa de cambio) - South American systems

A basic hawala-type of transaction involves a sender, two trusted intermediaries and a recipient. If one wants to send money to a friend in Pakistan, he or she would contact a local IVTS operator, who will keep a small commission or make a profit out of the exchange rate difference between the official and the kerb price of USD in Pakistan. He will contact by telephone, fax or email his counterpart, who will make the delivery. The accounts between the two IVTS operators will be settled through compensatory payments (i.e. when someone from Pakistan sends money to the US).

Imbalances, in case of heavier capital flows from one side, are settled by check, wire transfer, physical transfer of cash, bearer instruments, or money orders. Variations include settlement through legal or illegal trade of goods ranging from gold and precious stones to medical equipment and textiles.

Finally, traders frequently mis-declare the value of goods sent or imported. Under-invoicing practically means the sending of value, while over-invoicing leads to the receipt of value by the issuer of the invoice. Mis-invoicing can be used either as a method of settling imbalances among IFTS agents or employed independently as an IVTM (see below). In other words, false invoices can assist hawaladars in two ways; to settle up and to generate demand for hawala services given that the balances must be paid up. While mis-invoicing can effectively produce the same result as the ethnically specific IVTS above, it offers the added advantage of tax evasion.

Finally, the stored-value type of IVTS can be anything from an ancient “hundi”, bill of exchange or promissory note to the latest vehicles, such as pre-paid telephone cards, store certificates, etc. Any instrument that effectively stores value, such as a pre-paid credit card, can easily be used for funds transfer.

### **IVTM**

Traditional IVTS operators often interface with the formal banking sector, as they often need to make deposits, engage in wire or other transfers, and manage other businesses. The interface with the regulated banking sector is especially common in Northern and Western countries, but it also occurs in countries with extremely poor infrastructure, such as today’s Afghanistan, where hawaladars were found to hold accounts in several countries (Maimbo, 2002).

Comparatively smaller amounts can be transferred through widely accessible gift and money transfer services overseas. For instance, special vouchers can be bought through internet web sites. Clients provide a credit card number to be charged for goods (such as flowers, food or super market vouchers), which are received and used by a friend or relative in any continent.

Debit and credit cards used by multiple individuals are another alternative. Holders of bank or credit card accounts can have multiple cards on the same account and hand them over to other people, who can use them for withdrawals in other countries. Only the account holder may know, thus, who is taking the cash and for what purpose. However, even s/he may not know where it goes next. Similar and often more complicated alternatives involve internet companies offering payments and money transfer services from within the US or from overseas, including some based in secrecy or laxly regulated jurisdictions. Others facilitate payments and value transfers on the basis of gold deposits held in London, Zurich or Dubai. Such companies include names like Paypal, eBay Payments, also known as Billpoint, Yahoo! PayDirect, c2it offered by Citigroup, email payment services offered by the U.S. Postal Service through CheckFree; MoneyZap and BidPay, Evocash, E-gold, Osgold, NetPay, GoldMoney, Standard Reserve, icegold. In addition, X-Card, Cash Cards, and e-Bullion

provide alternative ATM cards, issued by offshore banks with access to most ATM machines, obtainable by any individual with an electronic currency account.

Next in the range of IVTM is the very important category of trade diversion schemes. These allow for hard-to-detect value transfers, the laundering of dirty money, as well as garnering illegal profits within a short period of time. They involve the purchase of legal goods at a discount (up to 50%), payment through a letter of credit, receipt of goods via an intermediary in a third country and diversion (i.e. return) of goods to the US. These goods are sold to wholesalers at a higher price, but one which still represents a discount (e.g., 20%) for the new buyer. In return, the seller receives legal money anywhere on earth as proceeds of a legal sale. In other words, buying a million dollars worth of goods for \$500,000 and re-selling them for \$800,000 in a couple of weeks generates a profit of \$300,000 and clean funds for anyone to use. Several billions of dollars worth of diversion probably takes place each year.

Finally, IVTM operators can also make use of a correspondent account used by their bank overseas at a US institution (they can draw money and, thus, make payments in the US or elsewhere). Quite importantly, correspondent (including nostro and vostro)<sup>2</sup> accounts can be used per se as the modern equivalent of a sophisticated hawala that moves much more substantial amounts without bank officials in the US or other countries knowing their customers' identities. This situation is particularly problematic in nested accounts, when large numbers of institutional and individual accounts are consolidated through a network of banks.

It is therefore clear that IVTS include a very wide range of methods from very low technology and simple ones to extremely sophisticated ones. All of them are

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<sup>2</sup> Nostro and Vostro accounts are held by banks at other banks in foreign currencies and jurisdictions, where they have no presence themselves. For example, when bank A from country X needs to engage in U.S. dollar transactions but has no offices in the U.S., it may open a nostro (literally "our") account with a New York bank B. When bank B, on the other hand, wishes to engage in transactions denominated in the currency of country X but has no offices there, it will open a locally denominated account with bank A in that country. This would be a vostro account ("your account"). These are essentially clearing accounts that balance transactions between the two banks. Whereas a correspondent account is more of a one-way service, nostro/vostro accounts serve reciprocal interests and are like "mirror" accounts.

consistent with the Patriot Act definition of money transmitter as “any other person who engages as a business in the transmission of funds, including any person who engages as a business in an informal money transfer system or any network of people who engage as a business in facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system” (Sec. 359[a]).

## **BACKGROUND AND METHODS OF OPERATION DISCOVERED OR SUSPECTED**

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In this section, each IVTS is discussed separately. The typical and less common methods of operations are outlined after a brief overview. While the main emphasis is on hawala and trade diversion, the other methods are briefly described in order to draw a more complete picture of the range of IVTS and provide an accurate context within which value transfers occur internationally.

### **PHYSICAL TRANSPORTATION – COURIER SERVICE**

This is the simplest and oldest way of moving value. It is important to note in many societies cash continues to be “king”. So, people simply take their cash along with them. If they cannot travel, they request the assistance of trusted friends or relatives. Alternatively, they may turn to companies specializing in the physical transport of goods or small amounts of cash. Some tracking companies also offer this service occasionally for a fee. The evidence suggests all of these variations continue to be extremely popular, despite the introduction of new technologies and the effects of globalization (e.g., extension of financial networks and banking facilities around the world, increased mobility of capital, trade expansion, etc.).

It is notable, however, that as globalization enhanced the mobility of people and goods across borders, the opportunities for this IVTS have clearly risen. In addition, it seems in regions or ethnic groups without the long tradition of hawala, trust has not sufficiently developed for that particular cost-effective and reliable means to thrive.

### **The Element of Trust**

As will be seen, trust is an indispensable element of traditional, ethnic methods like hawala. It is a key part of the infrastructure rendering global networks fast and effective. Among ethnic groups where this crucial component is absent, physical transport is a likely alternative. For example, reports of numerous intra-ethnic violent incidents and cases of predatory misconduct, even within families, are much more common among Albanians than any other ethnic group (interviews with Italian and Greek

controllers, Albanian and other immigrants). As expected, there is thus no evidence of hawala-type services among Albanian immigrants in Europe.

The same has occurred in the small Syrian minority in Southern Europe. In a concrete case, a group of Syrians got together to send collectively money to their families back home. The amount was several million Greek drachmas (at the time the rate was about 360GDR to the USD). Their trust proved misplaced: They had given the same courier money before, and the money was delivered on time without problems. This time, however, he disappeared with the money and without a trace (personal interview with friend of victims).

There is plenty of evidence, however, that self-carry, hand-carry by friends and in-kind transfers (clothes, consumer goods) take place massively even in groups with tradition in hawala or hundi. Transfers conducted in this way are observed in countries such as Pakistan, the Philippines, Sudan and Egypt where they could represent double or triple the amount of official remittance figures (Abella, 1989; Alburo and Abella, 1992). As much as 27 percent of all remittances to Pakistan may be going there by hand (Kazi, 1989). In Sudan, it has been estimated that in the 1990s, 80 per cent of unrecorded remittances was transferred in cash, while 20 per cent went in through smuggled goods (Brown, 1992). A good deal of this cash or travelers checks fuels the black market in the destination country (Puri and Ritzema, 1999) and consequently the cash pools on which IFTS operators draw (see below on hawala mechanics).

In some cases, hand carry is combined with hawala. For example, those who wanted to send money to family in Afghanistan during the Taliban period had a hard time using hawala channels. As most Afghani families had members residing in Iran or Pakistan, money senders from Europe of the US would use hawala to get the money to these two countries and ask that the money get hand-delivered to their loved ones, when the hawala payment recipients planned to travel back home (personal interviews).

### **The Importance of Culture**

Among traders from countries with cash-based economies, they frequently prefer to travel to the place where they purchase goods, keep the money on their person, make the payment, rent a van or truck and drive back to their residence. This is a practice, for

example, among Indian businessmen living in Europe (personal interviews). So, both legitimate and illegal trade may avoid both the formal banking sector and hawala for international payments. This shows how entrenched certain parts of one's culture can be even among immigrants living in technologically and financially advanced societies. This sort of "cultural inertia" can explain to a large extent also the resistance to change and new (esp. outside) banks and other financial institutions in Pakistan, India and other countries.

### **Unreliability of Other Methods**

Another contributing factor is the unavailability or unreliability of other methods. Immigrants have repeatedly tried to send remittances to their families through formal money transfer companies, such as Moneygram or Western Union, unsuccessfully. One interviewee reported how she attempted to send money to her relatives in Nigeria. When she notified someone to go and pick up the money, the relative was told that someone else had already received the money, probably using a fake ID. The company, according to the interviewee, could not do anything about it.

In another case, an Afghani refugee attempted to send €500 from Greece to his sister for her tuition fees through Western Union (WU), but the funds had not reached her for weeks. His inquiries went unanswered and only two-three months later did he receive a "Dear Customer" later vaguely referring to post 9-11 international rules. He assumed his name resembled someone else's on one of the terrorist lists. In the meantime neither his funds nor the €30 fee he had paid would be returned to him. After he sought legal counsel and many months later, the money arrived in Afghanistan. To this refugee and his sister, the €500 represented a lot of money. They were both extremely upset with Western Union and resented deeply the impersonal and indifferent way they were treated (personal interviews).

### **Cost of Other Methods**

The cost of sending cash overseas through formal institutions has also been excessive, particularly in proportionate terms. In the above example, €30 for a €500 remittance represents 6 percent. Most of the time, immigrants' remittances are for amounts as low as \$200 or even \$100. As the sending fee remains the same for amounts up to a certain level, the percentage becomes

unreasonably high. The sending company also profits from the spread between the exchange rates of the currencies involved. In addition, they keep the money for the time they take to deliver it (the float). There is, thus no need to charge predominantly low-income customers with such a high fee. This explains the number of class actions in the United States against formal remittance companies (Western Union, Moneygram, American Express) (van Doorn, 2002).

Stories about the unreliability, high cost and insensitive treatment of foreign clients spread easily and fast throughout ethnic communities, where the grapevine is quite efficient. As a result, members of these communities are suspicious of and shun formal remittance companies. This is an important reason why people resort to IVTS in general and courier services in particular.

### **Courier Methods and Routes**

There are several courier methods and routes. In this hemisphere, there were seizures of cash from travelers hidden inside bags, caskets or toys. Interviewees in Europe spoke of couriers transferring cash in diapers as well as inside their body or under their skin, often through careless operations resulting in serious infections or death.

In other cases, people informally organize and send cash or presents with someone who plans to visit. Nigerians, for example, can be found in many parts of the USA. They form associations through which trustworthy people can be found, who accept cash from different expatriates every time they visit the home country and deliver it to their families. The mother of an interviewee offers to help every time she visits Nigeria and carries cash for people in and near Lagos. The total amount carried every time she travels is below or just over \$10,000 (personal interview).

In some countries, when cash is found in the belongings of travelers, it is stolen or confiscated by the authorities, especially in Africa and former Soviet republics. When such risks are (or are perceived to be high), people convert their cash into mobile and re-saleable items that generally preserve their value. For example, before the collapse of USSR, there were currency exchange and capital flow restrictions. So, people who wished to move their money used to sell real estate property, purchase various goods/commodities with the proceeds, take the goods with them to another country, sell them there and get back as much of their money as possible. Today, however, with the

collapse of real estate prices, this is no longer practiced (personal interviews). Trucking companies and tourist agencies now accept packages and money from expatriates in Western Europe for delivery throughout Russia and the former Soviet republics, even in remote villages (personal interviews).

A review of police intelligence in a European country points to three main methods of physical money movements:

- a. When friends or relatives travel back home, they transport money hidden inside baby strollers, diapers or clothing.
- b. With legally or illegally earned money, gold and jewelry is purchased; jewelry is then handed over to trusted compatriots who go back home on a visit. The jewelry is worn by them for the transfer and is handed over to families and relatives of immigrants. The jewelry is subsequently sold in order to keep the corresponding amount.
- c. Money is hidden inside adults' clothing or in double-bottom suitcases, in order to cross the borders without declaring it.

Investigators have also seen “mules” carrying the cash inside their body, sometimes resulting in serious illness (personal interviews with Italian, Greek and British officials).

Courier services are used routinely in countries where money changers buy and sell currencies on a daily basis. Because they require the physical presence of the money to do their deals, wire transfers are not helpful. For example, in Jordan, Israel, and the United Arab Emirates, one routinely sees people traveling back and forth from Istanbul, Turkey or European financial centers carrying very substantial amounts of currency (case materials, media reports and interviews).

There are also reports of “boxes full of currency” shipped from the UAE to Pakistan, Kuwait, Saudi Arabia, and other countries. The shipments are insured to the value contained in the boxes, in case they get misplaced (personal interview with bank regulator).

Further, Afghani hawaladars, who need cash after they make payments, also transport the cash between Kabul and the rest of the country, interestingly using the same road official physical money transfers take (Maimbo, 2002).

The fees charged range from absolutely nothing to set payments or salaries plus travel expenses for “professional couriers” and standard fees for companies offering this service too (personal interviews).

Even though there can be no precise estimates of the total volume, the use of courier services is booming all over Asia, the Middle East and Europe. This is clear from seizures as well as interviews and other reports. The smuggling of cash in and out of the US is apparently taking place with considerable ease too, as rough estimates suggest that it amounts to billions of dollars annually (GAO, 1994).

The nexus of this IFTS with terrorist finance is quite strong: Media reports suggest that the Taliban may have used such services to get their financial resources out of the country before the recent war (Farah, 2003, see also his reporting in The Washington Post, and personal interviews and communications).

In India, media reports indicate that, besides hawala, funds flow into the country through militants who secretly cross the borders.

Finally, it bears noting that Zacarias Moussaoui, a defendant in the US accused of being a co-conspirator in the 9-11 attacks, brought the funds with him when he flew into the country and declared his cash with United States Customs.

### **IN-KIND PAYMENTS**

This type of IVTS requires more research for specific details and cases. The essence of this method is that services or work are provided on one end, while the payment for those occurs in another country. This is a simple way for residents of countries with currency and capital controls to engage in capital flight and tax evasion, as well as money laundering.

On a small scale, someone can offer to look after a sick parent or relative overseas, while getting paid in the United States, Australia or Europe. This is simply one hypothetical scenario. Any type of service can be part of such a deal.

The tourist business lends itself for this sort of practice. A travel agent may regularly send tourist groups to India and collect full payment from them in the USA. In India, an associate or counterpart may cover all local expenses of the group and request the payment to be made in a U.S. or other account maintained outside India. This may be an independent IVTS

conducted on a regular basis, a method for sheer capital flight, or a way of settling up mis-invoicing or hawala imbalances (personal interview with India controller).

Many expatriates would like to return and retire in their homeland. They feel more comfortable at home as well as proud and happy to show their success to their compatriots. Paving the ground for this return means also building a nice house. A local company can do the construction work for the expatriate and, again, have the payment deposited in an overseas account.

A variation of this, which mixed in elements of a black market currency deals, money laundering and several types of fraud, has been employed by Nigerians, members of a network present in the US and many other countries. The modus operandi involved *inter alia* the construction of a building in exchange for payments made overseas (case of Christopher Olusegun Omotunde).

#### **HAWALA AND HUNDI**

In Arabic, hawala means “transfer”. Consequently, formal bank transfers are conducted in “hawala departments” in parts of the Arab world. In Saudi Arabia, this often refers to a bank’s wire transfer department. It is more accurate, therefore, to separate formal from informal hawala. For the purposes of this report, hawala is used only as shorthand for informal hawala.

As note above, hawala payments are made fast, cheaply and conveniently in places where banking services are unavailable, expensive or unreliable. Trust is a defining element of hawala and makes the system extremely efficient. One is hard pressed to find a cheated client.

Inaccuracies about hawala abound in writings both before and after it became a matter of policy concern following the terrorist attacks. Firstly, hawala did not originate in times of political turmoil in order to bypass laws and currency restrictions or out of distrust for banks (Bosworth-Davis and Saltmarsh, 1995; NCA, 1991; O’Hara and The Wild Palms Foundation, 1997). Secondly, it is not very different from older and contemporary “conventional” banking practices. It is erroneous to state “transfer without money movement” is a distinguishing feature of hawala (Jost and Sandhu, 1999; Passas, 1999). Quite the contrary, this is a point of resemblance with formal financial systems.

Thirdly, what this author previously described as “facts by repetition” with respect to the inner workings of hawala, unfortunately continues with the same baseless quotation making the rounds of documents influencing policy and law enforcement practices:

- ▶ "...these parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (Malhotra, 1995: 1).
- ▶ "...these parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (O'Hara and The Wild Palms Foundation 1997: 1) [no quotation marks].
- ▶ "parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (Williams, 1997: 6; in quotation marks, but without reference to source in the web version of the publication).
- ▶ "Money never enters the formal banking system but is instead transmitted through alternative banking systems such as the "hawala" in India and Pakistan. These parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (UN General Assembly, Special Session on the World Drug Problem 8-10 June 1998; no quotation marks and no reference to original source). This paragraph contains an additional inaccuracies assuring us that money never enters banks. As we shall see, this is simply wrong.

The latest addition to this “chain letter” appeared in 2001:

- ▶ “Born out of political turmoil and a distrust of banks, these parallel banking systems are based on family or group alliances and reinforced with an unspoken covenant of retributive violence” (Lambert, 2001).

The accumulation of misleading conventional wisdom about this and other IVTS makes it even more important to establish the facts and drawing as much as possible on reliable sources rather than be content with the review of secondary data.

The precise origin of hawala is still a matter of debate with most writers agreeing that it is an old practice predating paper money and formal banking in the Indian sub-continent, that it facilitated trade and helped avoid the risks of physical transportation (Alert Global Media, 1996; Brown, 1991; el Qorchi et al., 2002; Miller, 1999).

“Hawala” and “hundi”, which are used interchangeably in parts of South Asia, should be distinguished. Hundi was one of the earliest and most important credit instruments in India (see Figure 3 below). It functioned as a remittance vehicle (hence the confusion with hawala), as an IOU, and as a bill of exchange.

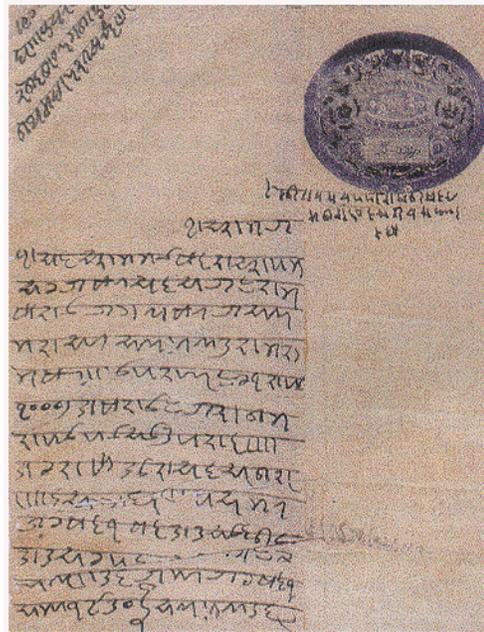


Figure 3: 19<sup>th</sup> Century Hundi (source: Museum Cell, Reserve Bank of India).

In simple terms, it was an early and popular bearer credit and remittance instrument, which resembled European practices in the 12<sup>th</sup> and 13<sup>th</sup> century. Bills of exchange were used in Florence and Venice at that time, but also in France and Britain later on, because of their convenience (Agarwal, 1966). As an IMF/World bank report notes,

“The practice of making the bills payable to order and transferring them by endorsement took its rise at the close of the 16<sup>th</sup> or the commencement of the 17<sup>th</sup> century. Bills of exchange seemed initially confined to foreign bills between English and foreign merchants. Their use was subsequently extended to domestic bills between traders, and finally to bills to all individuals, not just traders. The development of bills of exchange was the pillar behind the remarkable expansion of banking activity in Europe” (el Qorchi et al., 2003).

There were several kinds of hundis, each with distinguishing features (see Table 1 below).

**Darshani Hundi** was a demand bill of exchange, payable on presentation according to the usage and custom of the place. These were mainly of four types:

**Sah-jog** was a hundi transferable by endorsement and delivery but payable only to a Sah or to his order. A Sah was a respectable and responsible person, a man of worth and substance, who was known in the market.

**Dhanni-jog** was a demand bill of exchange payable only to the dhanni, that is the payee. This hundi was not negotiable.

**Firman-jog** hundis came into existence during the Muslim period. Firman is a Persian word meaning “order” and therefore, firman-jog hundis were payable to the order of the person named. These hundis could be negotiated with a simple or conditional endorsement.

**Dekhavanhar** hundi was a bearer demand bill of exchange payable to the person presenting it to the drawee. Thus it corresponded to a bearer check.

**Muddati Hundi** is a usance bill and is payable after a stipulated timeframe or on a given date or on a determinable future date or on the happening of a certain stipulated event. Muddati hundis of Sah-jog, dhanni-jog and firman-jog types had the same features as those attached to the same types of darshani hundis. However, the most important type of muddati hundi was the jokhami hundi, which was a documentary bill of exchange corresponding to the present day bill of lading. This had been in use for centuries and payment was conditional on the safe arrival of goods.

**Table 1. Source: bank regulator from India.**

According to an early 20<sup>th</sup> century study, hundis enabled advances, but could also be used as finance bills or trade bills. The hundi was payable either on sight ("darshani hundis") or at a later date (deferred or usance or "muddati hundi") (Jain, 1929).

Hawala, on the other hand, is simply the practice of transferring money and value from place to place. Hawala, thus, may or may not involve the use of a hundi (in modern times, it appears that most often it does not). Yet, in some countries, such as Pakistan and Bangladesh, the term used to describe the practice of hawala is actually “hundi”.

### **Terms Used in Hawala Networks**

The following are some of the words, terms and codes investigators into hawala networks are likely to encounter:

- “hundi” comes from a Sanskrit root meaning “to collect”
- “hawaladar” or “hundiwala” refer to hawala or hundi operator
- lakh (peti) = 100,000 (it is printed as: 1,00,000)
- crore (khokha) = 10,000,000 (it is printed as: 1,00,00,000)

- tola = 11.7 gr.
- masha = almost 1 gr. (1/12 of a tola)
- cloth = rupees
- metre = thousand

Recent code words that have been used by hawaladars in India

- “trouser” = telegraphic transfer
- “recorder” = one lakh rupees
- “cassette” = one thousand
- “India Today” = a note’s serial number
- “10” = 10,000
- “50” = 50,000
- “100” = one lakh

(Source for interpretation of recent codes: Jamwal, 2002).

### **Hawala Mechanics<sup>3</sup>**

Broadly speaking, there are two main aspects to the hawala business. The first is the sending and receiving of money the clients wish to transfer. The second is the settlement process. The former regards relationships between a hawaladar and his or her client, while the latter consists of relationships among intermediaries. For hawala to operate optimally, there must be pools of cash on both ends of transactions. This is how each hawaladar will make payments for the other’s clients and will not have to move money across borders.

There is one cash pool in labor-importing countries on one side (pool A) and another cash pool in remittance-receiving countries, such as Afghanistan, India or Pakistan on the other (pool B) (see figure 4).

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<sup>3</sup> Unless otherwise noted, the sources of information for this section are confidential files from law enforcement and regulatory agencies, suspicious activity reports, and hawala operators’ records I reviewed on a confidential basis.

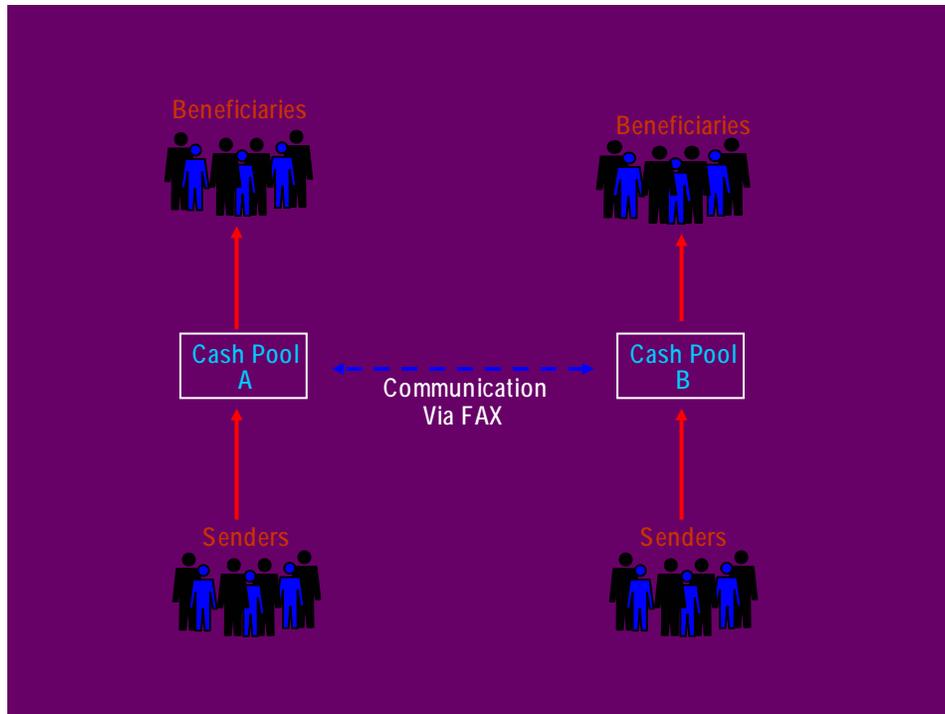


Figure 4.

For our purposes, the question is what fuels the business in the US on one side and in remittance-receiving regions, such as South Asia, on the other side.

The following is Cash Pool A, a list of clients with money leaving the US:

1. remittances of expatriates to their families
2. payments for imports
3. investment funds (in case of restrictions as, for example, in India)
4. services provided overseas but paid for in the US
5. over-invoicing of exports and bogus exports
6. tax evasion money
7. proceeds of criminal enterprises, such as cigarette or human smuggling, drug trafficking or any kind of fraud
8. contributions to militant and terrorist groups.

Not all of this money need go through hawala and, of course, not all of it does, but this is what drives the demand for this IFTS. Categories [1] and [2] are self-explanatory. One point to note about [2], however, is that hawala is by no means necessary with respect to many countries. That is, US-based importers can and do settle their debts to

partners in many countries through banks and other official channels. Using hawala for settling up with a Hong Kong or European trader makes little or no economic sense, if the transaction is legitimate. Whenever trades are off the books for whatever reason (e.g., imports from a country subject to trade, OFAC or other sanctions), then a hawaladar comes in handy.

Category [3] raises the question why one might go through hawala to make an investment in India. The answer is that there have been restrictions over the years on foreign ownership of Indian company stock. As India seemed to be an area of economic growth, many investors wanted to get around those restrictions and used hawala channels and ‘benami’ or nominee accounts (the use of someone else’s name for commercial or other transactions is not uncommon in the Middle East and South Asia).

As mentioned earlier (see page 25), a good illustration of how in-kind payments or services provided overseas [4] can generate cash on the US end of transactions can be found in the travel/tourist business.

Over-invoicing of exports [5] is a practice whereby one effectively *receives money* by sending goods to another trader. For example, if goods worth \$100,000 ship to Bangladesh but a business partner is invoiced for \$150,000, the shipper will receive an additional \$50,000 in the US. Why would a Bangladeshi agree? Because s/he may wish to minimize the official (declared) profit from the sale of these goods in Bangladesh, or because s/he would like me to deposit these \$50,000 in an account in the US. In other words, this is another method of evading currency and capital controls and converting to a hard currency overseas beyond the government’s reach. This seems to be a very common practice.

Would such a practice not entail, though, a higher import duty overseas? Not for all goods and not everywhere. In India, for instance, duty would not apply at all or would be very low for books or software programs. So, people who wish to whisk their (legal or dirty) money away from India would place orders for practically worthless books or (blank) CDs for which they would pay the US exporter through a phantom company that will cease to exist shortly after the payment is made from India. There are masses of unclaimed such shipments in India (e.g., Mumbai), sitting in warehouses and highlighting the extent to which this practice of “bogus exports” occurs. If someone claims these

shipments, the Indian authorities will be able to identify the offenders (personal interviews).

Category [6] includes money earned through legal activities in the US, but not declared to the tax authorities. This money could not be deposited in bank accounts or officially sent out of the country, so hawala is an attractive method of disposing of it.

The business of illegal immigration is thriving in Europe and the US in recent years, as does the illegal traffic of drugs, weapons and cigarettes [7]. Frauds of all kinds (e.g., Social Security, advance-fee or credit card frauds) also generate a great deal of cash to be laundered, if it is to be used in the legal economy. Hawala and other IVTS are very competitive mechanisms to launder this dirty money.

One of the most frequently used ways of financing ethnic insurgents has been to appeal to expatriate communities in various countries [8]. Almost all conflicts have relied on the patriotism and the convictions of immigrants to make a contribution “for the cause” (Naylor, 2002). In some cases, involuntary contributions are made through “shakedowns”. However the funds are raised, they often become available as cash in host countries and can be added to cash pool A.

As people from the United States would like their funds to quickly reach countries such as India or Pakistan, another cash pool (B) will be used to draw on and make the payments. What would these requests be? Trade is a big, but not exclusive, part of the picture, and not all of it is legal. The following is a list of clients sending money to the United States from India and Pakistan:

#### Cash pool B

1. families paying students' tuition overseas
2. families covering medical expenses overseas
3. tourists' money beyond amounts allowed by country with currency controls
4. flight capital
5. payment for imports
6. tax evasion
7. mis-invoicing of trade
8. bribes of politicians and government officials
9. laundered money from criminal enterprises

The first four categories relate to countries with currency and capital controls, for example India, Sri Lanka or Pakistan. The reason they restrict people's ability to move capital out is to prevent capital flight and to control exchange rates and foreign currency reserves. Annually, citizens and residents are allowed to remove a certain amount from the country. Under certain circumstances, exceptions are allowed, but the bureaucratic process may be slow and inefficient. So, for parents whose children study abroad, the allowance may be insufficient. The same applies to urgent medical operations that need to be covered very fast. Also, citizens traveling overseas often wish to spend more than their tourist allowance. Hawala-type methods enable all to circumvent the currency controls.

In addition, economic or political uncertainties, high inflation or perceived lack of solid investment opportunities motivate people with substantial amounts of money to channel their funds out of a country with currency controls [4]. This is a long-standing issue with many developing countries. Although capital flight is not seen as a matter for criminal law in the US or other market economies, the draining of capital resources and extreme volatility are issues of national security for certain societies. Capital flight from India to the US, for instance, was estimated in the billions of US dollars in the mid-1990s (Zdanovich et al., 1995).

Importers would have no trouble using banking channels to pay their counterparts overseas [5]. In some cases, speed and efficiency are the primary concerns; while in other cases the trading partners may be in countries subject to sanctions, limitations, etc. For example, some consumer goods have been subject to quotas in India and illegal imports through smuggling have been financed through hawala (see also below categories 7 and 9).

Tax evasion [6] is quite widespread in many parts of the world. So, a good part of the income and cash that is not declared to the authorities seeks to flee the country and/or get laundered. One interesting method of cheating on taxes is the use of certain laws in India allowing US dollar gifts to Indian residents free of taxes. Money leaves the country often through hawala and returns as a tax-free gift.

Whenever imports and exports are mis-invoiced [7], there is either plenty of cash from sale proceeds or over-payment of exported goods, which can join a hawaladar's

pool or fulfill a need to make a secret payment overseas to settle up. In the case of *under-invoicing* of imports, excess profit has been made in the local market part of which is owed to the exporter in the US.

A very common practice in parts of South Asia is that “speed money” (bribes) is paid by individuals and businesses in order to get things done or to avoid taxes [8]. Companies do not wish to enter those payments in their books, so they need to find cash. Hawaladars will sell at a discount or “rent” (loan) their cash. This generates additional profits for the hawaladar, who also ends up with the cash corrupt politicians receive and wish to take out of the country or simply launder. An Indian hawaladar interviewed emphasized this is the most important source of funds from the Indian end. The interface between hawaladars, corporations, bureaucrats, and politicians is very strong (e.g., recent scandals in India have made lay people associate hawala with corrupt politicians and militants). As another hawaladar put it “we help them out and they help us out” (personal interview).

Finally, all proceeds from criminal enterprises ranging from extortion, kidnapping, drug trafficking, smuggling of gold and diamonds or other precious stones, human trafficking, human organ sales, theft or fraud potentially enter cash pool B [9].

Moreover, the demand for certain goods might substantially exceed legally available supplies, as has been the case with gold in the Indian subcontinent (Cassara, 1998). The insatiable and culturally driven appetite for gold is not quenched by imports of non-resident Indians, some of whom specialize in this practice. Smuggling takes care of the rest. Tons of gold were smuggled (primarily from Dubai) over the years. The value of gold brought illegally into India has been estimated to be higher than a billion US dollars annually (Reddy 1996).

In addition, the sales of other smuggled goods add to hawala pools. As mentioned earlier, quota-breaking business involves the smuggling of consumer goods, which is financed by hawala and generates cash to be laundered or to continue such activities.

Therefore, hawaladar A will draw on cash pool A to make payments requested by hawaladar B. Conversely, hawaladar B will draw on cash pool B to honor requests from hawaladar A. This means that even if clean money is sent from the US, dirty money may be used to make payments to law-abiding citizens overseas. Sometimes, “black money” is

taken from cash pool B and used for illicit payments. This was the case in a big corruption scandal, when instructions were sent to India from London about where to go for cash pick ups - businessmen and traders - and where to deliver it - politicians and bureaucrats (Kapoor, 1998).

This, however, is still only part of the mechanics of hawala. The interface of legal and illegal actors becomes much more complicated in the settlement process.

### **The Settlement Process**

Each time a hawaladar sends payment instructions to a counterpart, he creates an informal debt or loan. If cash pools A and B were equal, settling up would be done simply through reciprocal payments. Yet, these pools are always asymmetrical. Whenever there is an economic or political crisis in Pakistan or India, for instance, cash pool B will grow a great deal, as many people would want to get their savings out of the country. At the same time, cash pool A is likely to shrink (fewer people would wish to send funds there as long as the crisis lasts). Other events can have a significant impact on these pools. The scandal around the Bank of Credit and Commerce International (BCCI) in 1991, for example, had a major impact on thousands of South Asian families, especially Pakistanis (Passas, 1995). In the aftermath of BCCI's closure, they were left without the vital services BCCI used to provide. As a consequence, the hawala pool in the UK and elsewhere grew substantially.

The closer the relationships among hawaladars, the easier the settlement process. Kinship and family ties made hawala work smoothly. In straightforward and small operations, a courier brings the cash from one party to another.

In another situation, one brother operated in South Asia and another in Australia. Each sibling took care of the clients of the other. Their imbalances would be settled in several ways. One method was the use of couriers to transport the money where needed. Another was to send excess money to a Dubai or New York bank account (see Figure 5 below). Also, money was sent to an account in Japan to purchase commodities for export to South Asia (Maimbo, 2002; personal interview). The proceeds of the sale would replenish the cash reserves in South Asia.

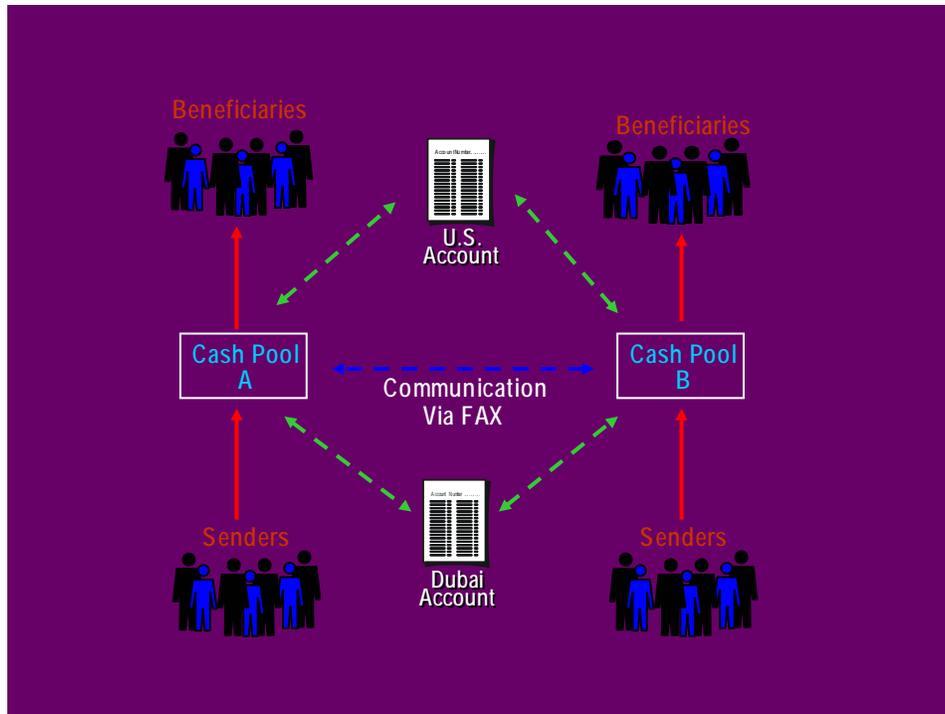


Figure 5

In the contemporary global economy, given the substantial amounts that are moving about, hawaladars also rely on people beyond kinship or even ethnic ties. This is feasible and likely in relatively small operations.

The preceding discussion was based on a simple relationship between two hawaladars. However, each hawaladar sends payment instructions and money to a variety of places within a country and around the world. So, how will they cover each other's positions? The settlement process lends itself to shady operations due to the informal nature of the transactions and networks involved.

There is little mystical about the settlement, which is very similar to the way formal banks go about their business. There is slight to no actual movement of funds in Western banking also. The main difference with hawala is that hawaladars are not restricted by rules on how and with whom to transact in this process. In other words, banks must follow the laws of each country in which they operate and transact with properly authorized people and institutions. Not so with hawala, where the informality of networks renders them flexible and free to bend or disregard laws, as they must do in India, Pakistan, Sri Lanka, France, Spain, Saudi Arabia and elsewhere. There is no doubt

that the “underground economy” or “black markets” play a large role in this part of the business. Some interviewees from South Asia have gone as far as to argue that this is precisely what gives hawala a competitive edge over money changers and other financial channels. This may or may not be entirely accurate, but no one seriously questions the interface of hawala with unauthorized dealers, “black money”, and illicit fund transfers.

Balances are also evened out through postal orders, checks, official drafts, bearer instruments or wire transfers. If both parties have bank accounts they do not mind using for this business, a bank-to-bank transfer is another option (as with the brothers mentioned earlier; see Figure 6 below on one-way hawala traffic).

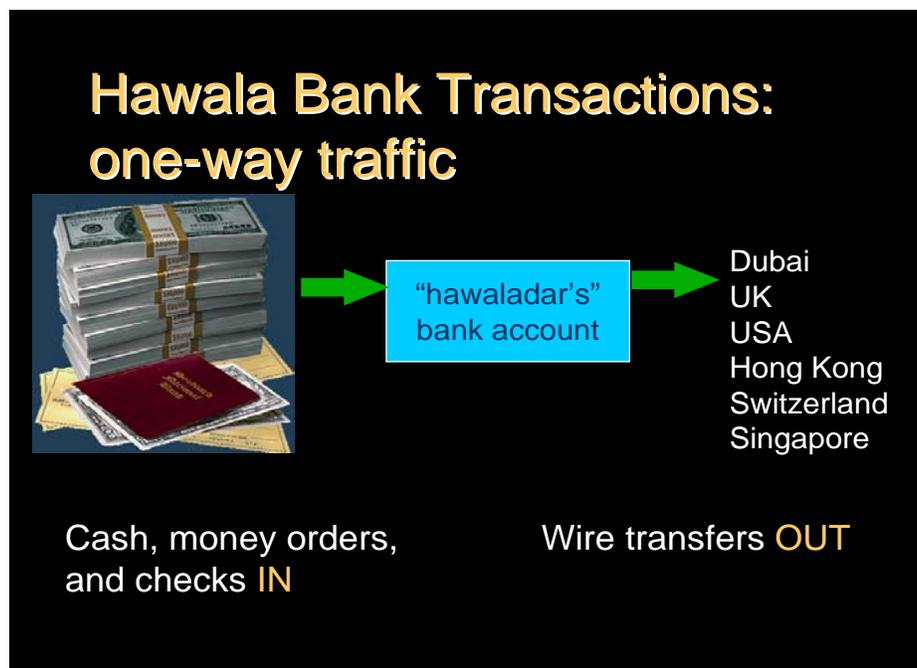


Figure 6: One-Way Hawala Traffic

A hawaladar in South Asia may have accounts in the UAE, London, New York, Tokyo or Hong Kong for at least three reasons. One is to settle positions with counterparts in one central place, thus consolidating accounts and reducing costs (i.e., whichever side of a given transaction has a cash surplus, sends it to a clearing account for use by the other party; this can involve pure “selling” of currency without much involvement beyond the transfer to a bank account). Second, accounts in several

jurisdictions allow for the hawaladar to serve his customers, even if he does not have a counterpart in a given country. Third, hard currency accounts make conversion from and to other currencies easier. They also provide stability for the whole business, as the rates are unlikely to fluctuate dramatically in short periods of time. Such accounts also assist hawaladars in taking their own profits out of the country in which they reside and diversify their financial resources.

It is noteworthy that even in a completely ruined country, such as today's Afghanistan, hawaladars are able to and do hold accounts in major Western financial centers as well as Kabul, Peshawar, Mumbai or Delhi. In other words, even in a war-torn society, hawaladars of a certain size do not require or resort to 'wholesale' hawaladars to settle up. A similar absence of "wholesale" hawala with lack of records and knowledge of where the money comes from and where it is going can be seen with respect to Somali and Yemeni money transfers. These are also countries with poor banking and general infrastructure, for which it would make a lot of sense to consolidate through "wholesalers".

There is no doubt that there are several layers of hawaladars who may play a part in the global networks. Indeed, most of them settle up through centers like Dubai, New York, London, Hong Kong, Singapore and Switzerland, as this offers economies of scale and better currency rates. In many instances, cash pools are sold from one hawaladar or money changer to another. Settlement may also take place through payments to third parties around the world. Figure 7 illustrates how money exchange houses in the UAE and other countries trade in various currencies and settle their accounts directly or through third parties.

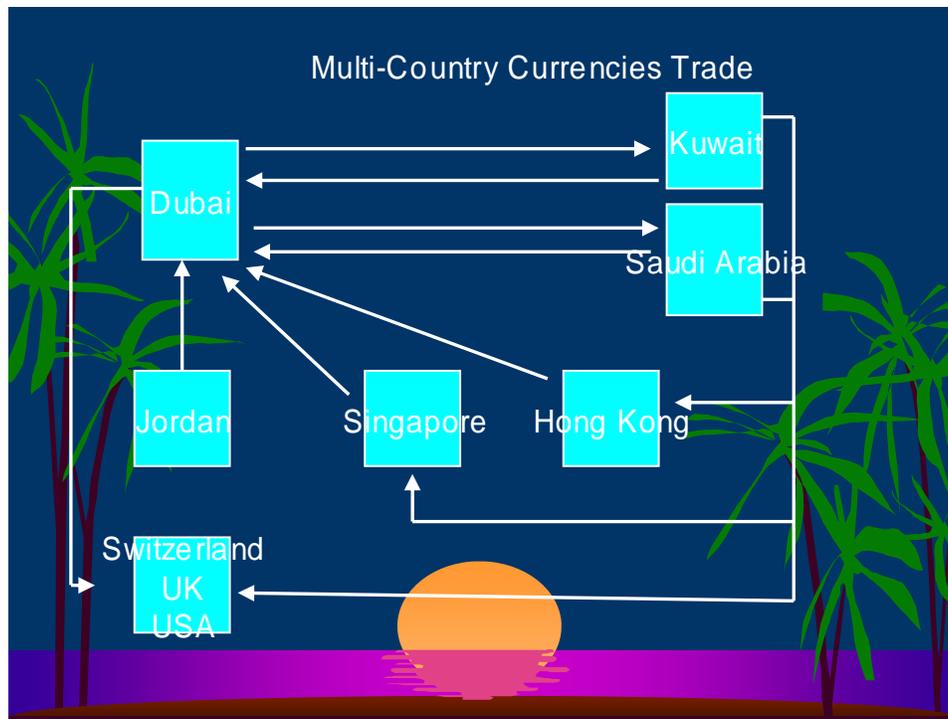


Figure 7. Illustration of the Currencies Trade among Money Changers Based in Several Countries.

The reasons money changers and hawaladars settle up via third parties or countries are: a) cost savings on fees and exchange rates; b) faster settlement; and c) lower financial risks since they are able to close positions with correspondents faster.

Due to the multiple layers in hawala networks and the settlement process, some observers use the term “wholesale” hawala for nodes in the system assisting in the consolidation of accounts (Ballard, 2002; el Qorchi et al., 2002). A wholesale hawaladar might be someone presumably involved only in the settlement process. In other words, he would not be transacting with retail customers, but would play a role in the balancing of accounts for several smaller-scale hawaladars operating in several jurisdictions. This requires a situation in which a small number of “wholesale” hawaladars make very substantial deals with a large number of smaller operators. Wholesalers would have no connection with individual remittances but would play purely a role of financial intermediation by buying, selling and consolidating the claims and liabilities of lower-level intermediaries. This would involve a very large network and very high currency volume.

Yet, there is no credible empirical evidence to support this scenario. Because this seemed like a logical hypothesis, both this study and that conducted by IMF and World Bank researchers looked initially for such consolidators. Searches were undertaken in Dubai, where rumors had it that this was the center of hawala high-level consolidation, in the UK, in the USA, Pakistan and India. Beyond reviewing the literature from media accounts to scholarly publications, attention was paid to this question in interviews with hawaladars, their clients and controllers with hands-on experience with hawaladars. However, not a single person or company would identify their role as a hawala consolidator. While it is possible that there is more than one level of consolidation, the number of such levels remains unknown<sup>4</sup>.

Moreover, a “wholesale hawaladar” would not really be doing hawala at all. The transactions of such a consolidator would be primarily of a financial nature connecting hawala operators with formal banking institutions. While highlighting the interface between hawaladars and the formal financial system, it would be a stretch to call such an intermediary a hawalada. The banker who helps a hawaladar send a wire does not become hawaladar himself. In the same way, an arbitrageur or broker who interacts with multiple hawaladars through banking, trade and wire services should not be regarded as a hawaladar either. Even though some may consider such an intermediary as a “hawaladar of hawaladars”, he is more akin to a correspondent banker.

As stated above, some also emphasize the role of family, inter-marriage and kinship in hawala. As we move to high levels in the settlement process, however, such links almost disappear and funds are transferred across ethnic groups (Arab, Jewish, South Asian, African, Chinese, S. American, etc.).

At the same time, many international hawala operators employ quite complex settlement methods through both legal and illegal trade, third party accounts, nominee accounts, shell companies and multiple jurisdictions. Let us take a look at a small sample of scenarios illustrating how these operations work.

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<sup>4</sup> Observable in India, Pakistan and elsewhere are couriers (mostly men and boys) that get a set amount (or, sometimes, a commission of 1 per thousand rupees) for going from city to city picking up cash and from village to village to make deliveries.

A relatively common scenario involves the smuggling of gold or precious stones. Hawaladars or other intermediaries maintain accounts usable for clearing purposes. Once hawala funds reach this account, the hawala agent or a partner of his uses them to purchase gold from various countries. The gold is then legally exported to Dubai and from there smuggled to India. The gold is subsequently sold in the black market and the proceeds join cash pool B (see cases 26 and 27 in appendix). The same mechanisms can be used with precious stones, medicine, medical equipment, car and bicycle parts or any commodity. The smuggling part is essential when one of the aims served is to break an embargo, evade sanctions on a country, quotas, taxes, customs duties or any other restrictions regarding the country of origin or final destination.

Remember that some of this trade can be legitimate, although in many instances it is impossible to see the commercial or economic reasons for using the hawala business for financing (i.e., this can be done through properly documented and sanctioned routes without risking reputational or legal damage). In some of these cases, money laundering can frequently be the underlying reason for going through hawala.

It is important to note that tainted money does not return for the most part to Africa, South Asia or comparatively unstable economies after laundering. The dirty cash may be used for all sorts of deals in the interim. This is one reason why it is important to separate the hawala payment system from the settlement aspect. Those with access to cash from drugs sales in the US can use hawala to finance other people's trade and keep the money in another country under a legitimate façade.

The following is an example of how the laundering of significant amounts of criminal proceeds in the US can occur. The money is not usable for legitimate purposes, so it 'leaves' the country on paper and get back clean. The money may actually join cash pool A to satisfy the needs of overseas clients. If the amount is too high, however, at least a large part will be wired or sent by online banks or couriered overseas to a big trade center such as Hong Kong or Dubai. Once physically moved or converted to cash, the funds purchase goods such as textiles or computer equipment. The goods can be "exported" to Afghanistan to areas enjoying duty free status (i.e. under the "Afghan Transit Trade"), and then are diverted to Pakistan, Iran or Turkey and Europe. Besides duty free zones and routes, another problem has been the asymmetric customs duties

between Afghanistan and Pakistan (they have been lower in Afghanistan). As a result, importers have been smuggling goods across the Pakistan-Afghanistan border, sometimes bribing border officials too (personal interviews).

When protectionist measures, such as subsidies and price supports, are introduced by governments, there is evidence of carousel frauds, whereby the origin, destination, quantity and quality of goods are falsified (Passas, 1991, 1999b). If the smuggled goods are sold in the legal market, clean money becomes available. In this way, drug money is integrated back in the metropolis and not in South Asia. On the other hand, some of these goods can be sold in the black market generating a need for money laundering. Moreover, regardless of whether the goods are sold in South Asia, the Middle East, Europe or North America, at least some of the money can be used to finance terrorist groups or cells. As a recent study in India pointed out, a great deal of the transfers from Dubai to Punjab are funding militant groups (Jamwal, 2002).

Another scenario involves straightforward invoice manipulation and bogus export of “antiques” or books to India. A wealthy trader wishes to send illegally derived funds from Mumbai to London. He orders and pays for the shipment of books that can be purchased cheaply (by weight) in England. He places the order through a company that will be folded as soon as the deal is done. The value of the books is exaggerated, so he can send a payment that raises no eyebrows for the invoice he receives. When the books arrive in Mumbai, he does not go to claim them, so that the authorities cannot trace his identity. Another fashionable scheme employed in India involves the purchase of useless goods that are described on paper as “antiques”. Quite a lot of “rubbish”, thus, gets exported to India with very high value declared, so that the capital flight or other needs of Indian residents can be met (personal interview).

Similarly, the value of genuine imports can be understated, so that duties are evaded. In such a case, two things happen: 1) The importer now owes his trading partner the difference between the real value of the goods and the stated one. So, he will use hawala to compensate the exporter in the US. 2) The importer’s profits will be officially much lower and income taxes will be evaded. The extra profits may flee India or Pakistan via hawala for diversification or other reasons.

Businesspeople involved in these practices do not have to be into hawala themselves. If they are, however, they can very easily mix the cash flows of their “day jobs” with hawala and obscure illicit deals. In this way, massive amounts can be sent or received according to one’s needs.

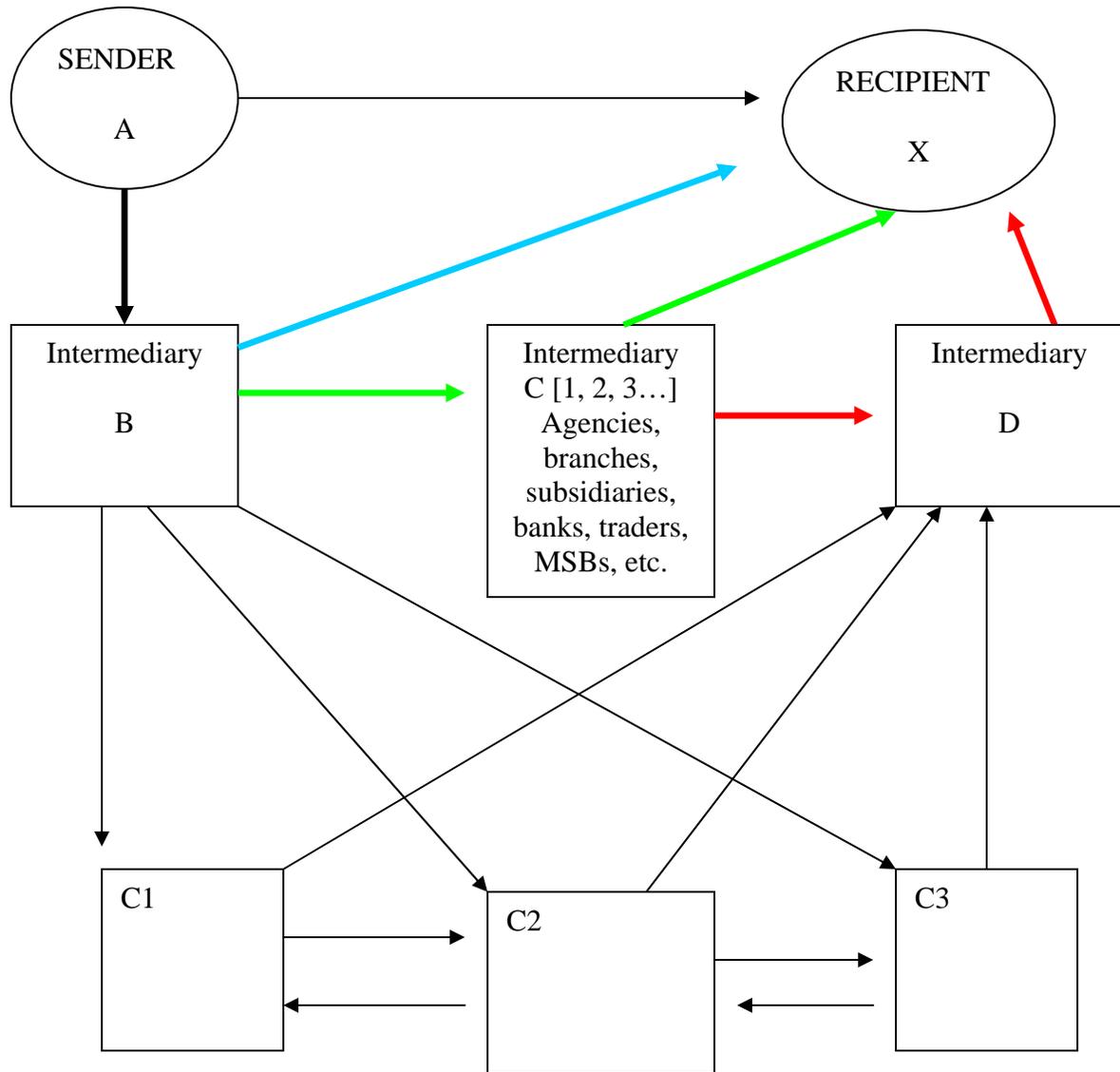
“Kleptocrats” may keep their loot in private banking departments of Western banks. Before getting there, however, the money often passes through hawala, as scandals in India (Kapoor, 1998) and Pakistan have demonstrated. Asif Zardari, for example, the husband of former Prime Minister Benazir Bhutto, accepted bribes that were actually not paid in Pakistan. It appears that he engaged in complex transactions that involved not only hawala, but also nominee arrangements (i.e. accounts and deals under a front-man’s name), shell companies, real estate deals, and bank accounts in off shore secrecy jurisdictions (confidential case material and personal interviews).

In addition to these scenarios, hawala cases have involved the financing of smuggling from humans to precious stones, embargo busting, trade in human organs, credit card fraud, and money laundering. Whenever prohibitions and regulatory restrictions lead to a high differential between official and black market rates in the price of currencies or gold, there is a corresponding increase in the volume of hawala transactions. In this light, the following points need to be stressed again.

First, even if the remittance senders and recipients deal with honest money, the cash pool on which the hawaladars draw may mix dirty funds, while the settlement process may have involved shady operations.

Second, various IVTS operators may be involved at different stages, as the settlement process can implicate numerous intermediaries and users of funds. Some of them may be honest, others naïve, still others straightforward criminals. Some may be aware of what is going on, while others see only the legitimate side. So, the whole settlement process is likely to generate interfaces of the innocent with dirty operators and clients.

Third, the settlement process can be intentionally fragmented in ways that each jurisdiction only gets to see or detect a small part of the total picture. In this way, very substantial amounts and serious misconduct can be masked. So, the basic mechanics of hawala can get a lot more complicated in the settlement process (see Figure 8 below).



**Figure 8: Mechanics of IVTS and Settlement Process in IVTS with Multiple Intermediaries C**

1. A-X [physical transport; in-kind payment; pre-paid tel. cards and stored value]
2. A-B-X [courier, epayment, credit and debit card use]
3. A-B-C-X [hawala and other traditional IVTS; wire remitters, in-kind payment; gifts and vouchers]
4. A-B-C-D-X [trade diversion; correspondent banking; mixed IVTS, including sophisticated hawala]

### **How Do Hawaladars Make Profit?**

In a nutshell hawaladars produce income by:

- Taking advantage of exchange rate differences (arbitrage)
- Selling or 'renting' cash
- Charging commissions or flat fees
- Financing of legal or criminal trade

Moreover, individual traders or businesspeople may engage in hawala operations without expecting any direct financial gain. For example, IFTS may constitute a

- Loss leader; advertising cost
- Non-profit service

There have been numerous cases in which particular clients were not charged anything for sending money to their family in the homeland. This tended to happen before 9-11 in several ethnic communities. Interviewees from Iraqi, Kurdish, Afghani and Somali communities mentioned instances where poor immigrants were offered this service free of charge. The same sometimes happened for very small amounts and among friends. One operation was entirely non-profit for all clients sending remittances from Australia to Africa (see Passas, 1999).

Apart from such exceptions, the main aim of engaging in hawala is to make profit. This could be done indirectly. That is, by offering money transfer services for free in order to attract more clients to the main business, such as a travel agency or retail store. The most common and direct way of making profit, however, is by arbitrage: exploiting the difference between the exchange rate agreed with the customer and the rate obtained in the black or other markets around the world. Table 2 shows the discrepancies over a twenty-year period in several countries.

Table 2. Black Market Exchange Rate Premiums, 1981-2000

(In percent of previous period official rate?)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Algeria	247	266	330	369	389	246	419	416	358	264	83	300	358	250	175	133	125	150	100	100
Bangladesh	41	41	42	45	130	218	211	272	210	199	136	67	40	30	19	19	11	0	0	0
Ecuador	29	96	64	91	85	0	31	38	16	23	19	10	6	5	4	2	5	11	0	0
El Salvador	84	34	98	100	204	82	100	195	85	36	12	12	18	15	15	10	10	11	0	0
Guatemala	22	25	70	24	45	15	33	28	9	22	14	4	5	4	4	2	2	0	0	0
India	9	13	28	16	17	8	13	14	12	15	18	4	5	5	6	6	3	2	2	2
Indonesia	4	1	0	2	0	11	16	16	3	1	4	26	9	7	5	0	6	11	5	5
Iran	403	379	320	562	557	977	1,576	1,030	1,965	1,965	3,252	3,360	88	100	150	193	186	150	400	200
Pakistan	41	25	30	11	0	1	19	10	0	6	9	8	8	8	6	6	11	25	20	20
Philippines	6	7	50	1	1	2	8	3	4	6	6	1	2	4	7	9	0	0	0	0
Sri Lanka	6	10	38	32	15	3	2	36	25	16	9	10	6	4	1	1	0	0	0	0
Sudan	3	57	54	102	43	122	85	270	344	915	52	95	78	50	25	10	0	11	5	5
Tanzania	193	205	301	287	281	248	139	100	35	50	59	36	9	8	6	4	7	11	5	5
Turkey	20	15	11	1	0	7	8	9	2	1	6	6	4	4	4	0	4	0	4	4
Zimbabwe	53	51	192	80	53	70	50	47	76	37	50	33	19	15	10	7	16	900	400	400

Sources: el Qorchi et al. 2002; Levine and Renelt; *World's Currency Yearbook* (for 1985, 1990-93); Adrian Wood *Global Trends in Real Exchange Rates: 1960-84*,

World Bank Discussion paper no. 35. 1988; *Global Development Finance & World Development Indicators* (for 1996-1997).

Certain missing values interpolated by the authors..

As can be seen, the incentive for hawala can be extraordinarily high. In those cases, the services to retail customers may be offered for free, given the substantial profits to be made in the exchange arbitrage. We also observe that in India, these asymmetries were drastically reduced towards the end of the decade. This was due to a gradual liberalization of the economy. This means that hawaladars had to use additional sources of profit to stay in business, as a 2 percent differential does not leave much room for the various intermediaries and their cost.

A good alternative is to charge a commission or set fees for the service. There is a very wide range of fees and charges IFTS clients have to cover. From completely free service to 20 or even 25 percent of the amount sent. The cost varies according to the origin, destination, urgency, amount to be transferred, and the relationship between IVTS operator and client. The costs have risen in the aftermath of the 9-11 attacks and the new focus on money service businesses in the US and internationally.

Epigrammatically, the commission rates depend on:

- the place of ultimate destination (higher rates for remote villages);
- the amount to be transferred (possible discount for large amounts);
- the relationship between hawaladar and client (i.e. if they are friends);
- the frequency or regularity of transfers<sup>5</sup>;
- the urgency of the payment (higher fee for overnight delivery);
- whether the remitter gives his cash before or after confirmation of payment on the other end (occasionally no cash is given until the recipient notifies the remitter that the money is there);
- the currency for payment (local currency versus US dollars, Euros, etc.);
- the country of the recipient (the rates are higher for countries lacking basic infrastructure or are subject to sanctions, embargos, etc.; so, rates would be higher for Somalia, Afghanistan, Iran or Iraq, but lower for India or Pakistan);
- law enforcement practices (how aggressively they enforce the rules), and
- the understanding of the hawaladar that the cash received is dirty. This is logical, because the rate charged must reflect the risk of detection and getting in trouble with authorities. This has also been true in most cases seen by this author. In South Asia, however, this may not be so, because the practice of hawala itself is illegal.

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<sup>5</sup> In some cases the regularity of payment strengthens the relationship and trust between hawaladar and client. The person making the local delivery is often a friend of the remitter. The local person conceivably makes no money for such deliveries (personal interviews in India). Sometimes, in the case of Somalia, a regular recipient may even receive an advance free of charge, if there is an occasional delay once in a while, particularly when local families depend on these remittances for survival (ILO Mission, 1999; Omer, 2002).

In some instances hawaladars accept money only from known customers and may refuse to deliver money coming from flagged countries, such as Afghanistan (personal interviews).

Two changes occurred in the aftermath of 9-11. Firstly, the cost of each transfer rose. It used to be that amounts up to \$5,000 would cost a flat \$5 fee, while higher amounts would cost \$10. The new rules requiring registration, licensing, record keeping and the filing of suspicious activity reports apparently increased the cost for those who stayed in the business legally and the legal risks for those who opted not to declare themselves to the authorities. So, the charges are now higher (most range between 2 and 5 percent depending on the destination).

The second change relates to the modus operandi. Many South Asian hawaladars had the cash delivered first and then took the remitters' money in the US. This provided additional certainty to customers who received confirmation that their money had been received before they paid out. This practice stopped in the post 9-11 context. If anyone still desired to receive confirmation first, it could still be possible, but for a higher fee.

The highest commission recorded for this study was for funds going from the US to countries under sanctions, such as Iran or Iraq. Whereas immigrants based in European countries could send money for 5-10 percent to these countries, remitters based in the US would have to pay 20-25 percent (personal interviews). This differential creates incentives for intermediaries who could receive funds in Europe (or Canada) and forward them to these destinations. Very often, traders get involved in those countries, as they are able to pay families of immigrants locally and purchase the dollars or Euros of the immigrants in order to pay for goods they wish to import – openly or clandestinely. The busy ports of the United Arab Emirates are one transit point both for funds and commodities, but there are others too (e.g., Hong Kong, Singapore, the Netherlands, Panama, the tri-border area in South America, etc.). Moscow and Russia in general are emerging as very important points of intermediation with South Asians, Chinese, as well as Middle Easterners.

Another means of profiting from hawala is the selling or 'renting' (lending) of cash available on either end of the transactions. Some major customers fuelling the need for hawala in South Asia are politicians, bureaucrats, businesspeople, and industrialists. Unfortunately, this region suffers from widespread corruption, even for simple tasks. As an illustration, an Indian research assistant went to meet officials with whom she had appointments, but she still had to

pay her way into the building in Delhi! According to interviewees, people “on the take” and those who pay bribes generate a huge demand for hawaladars, who make money by furnishing cash used to bribe officials.

Finally, the financing of both criminal and legal trade is another significant source of profit. As most hawaladars are also shop owners, traders or entrepreneurs, they can use the cash to make their own deals or facilitate those of others. In this sense, the honest or dirty cash they receive from their customers provides liquidity and free financing. When that happens, there is no need to charge their retail clients with high rates or anything at all, because their profit is generated elsewhere.

A close relative to the financing of illegal trade is that of straightforward money laundering, for which a commission is charged to start moving the money around to obfuscate its original source and owner, and to integrate it back into the conventional economy. The rates charged by IVTS operators in Latin America and the USA are much higher (up to 20-25 percent of the amount laundered) than in Europe and South Asia, where the charges are down to 2 percent or lower<sup>6</sup>.

Because of the frequent interface between hawala, trade, terrorist finance (see below) and transnational crime, it is strongly recommended that a follow up study focus on this nexus.

### **Documentation Kept**

Understanding the layers of intermediaries in specific hawala networks is crucial for investigators searching for money trails and evidence that can stand up in court. Different documentation is kept by different participants in the network. Because the payment instructions go in one direction (where the final destination of the money is), whereas the funds follow a different path, putting the two together is indispensable to determine the commission of particular offenses.

As remitters hand their money to hawaladars in labor importing countries, the usual records kept include the amount in local currency, the equivalent in US dollars (if not in the US),

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<sup>6</sup> This possibly reflects the ease with which laundering is done in different parts of the world as well as the competitiveness of the market; that is, how many alternative methods for doing the same thing may be available. In Europe and S. Asia we find both diverse law enforcement practices/priorities and the popularity of courier services, physical transportation in bulk, as well as trade-based laundering methods. However, examining those issues would take us beyond our present scope.

the rate for the currency to be delivered, the name of remitter and recipient, delivery location and date. Some hawaladars may receive funds from their agents for whom they may also arrange the delivery in various locations. At the end of the day, they might “close” the accounts: at 4.00 p.m., the hawaladars consolidate the information about each agent or sub-agent, amounts for delivery in each country and location, and send the fax or email with payment instructions to counterparts overseas. Delivery will take place the next day (urgent deliveries can be arranged by phone). The fax looks like the sample (with identifiers changed) in Figure 9 below. At the bottom of this fax, the hawaladar quotes the serial number of a rupee note, which helps identify the rightful recipient. The recipient produces that particular note, which is kept by the delivering hawaladar as receipt.



Figure.9: Sample of Faxed Payment Instructions.

The records kept by the sending hawaladar would look like the sample below (Figure 10), with the running balance with a given agent or counterpart entered at the right end of the spreadsheet.

1997							
TOTAL	==	54812.42		80000	3456000	86943.4	-6943.4
<b>Destination</b>	<b>RATE</b>	<b>£from clie</b>	<b>SELL RATE</b>	<b>\$Credit</b>	<b>RS Debit</b>	<b>\$ Debit</b>	<b>\$ BAL</b>
							0
Jagraaon	39.75	2301.587	63		145000	3647.799	-3647.8
Ludihana	39.75	2968.254	63		187000	4704.403	-8352.2
Gorayan	39.75	1587.302	63		100000	2515.723	-10867.9
Uppal Khals	39.75	3164.557	63.2		200000	5031.447	-15899.4
Chaachoki	39.75	1968.504	63.5		125000	3144.654	-19044
khoje'	39.75	1593.625	62.75		100000	2515.723	-21559.7
Sansarpur	39.75	2380.952	63		150000	3773.585	-25333.3
Shanker	39.75	1600	62.5		100000	2515.723	-27849.1
Jettawali	39.75	7905.138	63.25		500000	12578.62	-40427.7
Naugajja	39.75	2142.857	63		135000	3396.226	-43823.9
Barsal	39.75	1739.13	63.25		110000	2767.296	-46591.2
Poodra	39.75	3968.254	63		250000	6289.308	-52880.5
Manak Rai	39.75	5000	63		315000	7924.528	-60805
Balachor	39.75	2000	63		126000	3169.811	-63974.8
Rampur Jhaj	39.75	1574.803	63.5		100000	2515.723	-66490.6
Dugga Kalar	39.75	1600	62.5		100000	2515.723	-69006.3
Odhpur	39.75	1587.302	63		100000	2515.723	-71522
Chandigarh	39.75	3174.603	63		200000	5031.447	-76553.5
Amrit sar	39.75	6555.556	63		413000	10389.94	-86943.4
Chhajali	39.75	0	63.25			0	-86943.4
	1.6257	49209.57		80000			-6943.4

Figure 10. Sample Ledger kept by Hawaladar.

Hawaladars commonly keep a separate book for each agent with whom they deal. They usually specialize in one country - their country of origin - but they almost always assist with payments to a long list of third countries. So, they constantly call other hawaladars to make deals, to buy and sell various currencies. The margin between the buy and sell price in this currency trade is their profit. The cost of delivery to ultimate remittance recipients for their counterparts' clients is built in to the price of the currency they buy. The records of all these deals, calculations of fees and currency exchange rates are kept, at least for a while until all deliveries are made without a problem. In the West, many hawaladars keep their records in computers, so they do not have to purge them regularly. In remittance-receiving countries, however, these records may be kept for a shorter period, as they constitute evidence of illegal activity (in countries where hawala is or was outlawed).

Who knows their customer and how well is an interesting question about this business based on trust and where the recipient comes to the office simply with a rupee note<sup>7</sup>. The bearer of the note with the specified serial number communicated by the sending hawaladar as a way of identifying the legitimate recipient can be effectively anyone. If hawaladars do not know their customer, they cannot tell much about the origin or purpose of the remittance.

For the most part, however, the clients are known community people or are referred by a member of that community. Our interviews suggest that enhanced regulatory compliance in the sense of “know your customer” practices and suspicious activity reporting might not be unrealistic for all hawala operators in the US. For example, an informal remitter explained how he knew each customer entering his office. After some greetings, basic information was taken from customers (sender name, address, phone number, reference to a clan in some cases, same information for receiver). The operator entered the information into a computer spreadsheet, which was maintained for several years. The operator indicated that he does in fact know his customers. Along these same lines, an IRS official based in the same area commented: “They (hawaladars) basically do know who their customers are based on trust, which is how their operations work. They know who the customers are and how they came to utilize their service.” On the other hand, some hawaladars may serve a wider clientele (cross-ethnic groups) and therefore do not have the same degree of familiarity with the patron base.

Sometimes, a hawaladar can tell a particular deal is suspicious, as is the case with a client asking for a transfer to a country for which banking facilities are available, accessible and inexpensive. Asian hawaladars in the US confirmed that they clearly understood their customers to be involved in illegal activities in such cases. As they stated to a law enforcement agent: “if it was legal, why would they come to me”? (personal interviews)

There are Indian networks involving several intermediaries before the money is pooled together and channeled to particular accounts for further credits. Interestingly, in those cases, it was the lower level intermediaries who had no idea where the money was going. They were simply collecting cash and money orders or checks, without a payee’s name filled in, and were sending them all up the chain within the same country. It was higher up that people would fill in the payee details and make deposits in company accounts, which used the funds for the usual

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<sup>7</sup> An ID card is used often in Pakistan, but typically not in India.

trading operations (as well as the parallel support of smuggling illegal workers from India, Pakistan and Bangladesh; see case 22 - Operation Seek and Keep in Appendix).

There were cases in which someone is employed to collect sizable amounts of cash from a certain address and deliver them to another person. Again the serial number of a rupee note is used as identification, so the cash is not handed over to the wrong person. This cash pick-up and delivery person would certainly not have minute details of the clients. However, he would have the instructions, names and telephone numbers as well as addresses of his contacts. Those records would be maintained, but later probably thrown out as soon as the job is done. The point is that, even at this low-level of the hawala chain, sometimes people do know quite a lot at least about their immediate contacts (interview with Somali hawaladar).

The same happened in a big “hawala corruption scandal” that rocked India in the 1990s, which involved important politicians, industrialists and companies. Details for payments were going to India from operators in London and Dubai. Records of them were kept locally as well (the famous “Jain diaries”; see Kapoor, 1996).

So, one could not make the generalization that the higher one goes in the hawala chain, the fewer details one sees and the fewer records are kept. It varies from case to case, and the main challenge is the interpretation of hawala records, which are not uniform across ethnic groups. What is certain is that hawala is far from the media-portrayed myth of a “paperless” transfer system that leaves no trail whatsoever for investigators.

In sum there are cases where people know exactly who their clients are and whether the money is dirty or not. In other instances, when agents and intermediaries, such as cash pick-up and delivery people are involved, they may have limited knowledge of their clients or the clients of the agents they meet. The problem with hawala consolidators involved in the settlement process appears to be similar to the difficulties we encounter with correspondent accounts--because of consolidation of several clients, they may not know absolutely everything. Just like formal banks, hawala is not by definition criminal. Yet, just like banks and other financial institutions, it is vulnerable to abuse. And it does get abused. Therefore, hawaladars operating out of Western countries, can and should be careful with whom they do business and what records they keep.

## **LAW ENFORCEMENT CHALLENGES STEMMING FROM THE NATURE OF HAWALA OPERATIONS**

In several countries, hawala operates in parallel with formal financial institutions or as a substitute or alternative for them. Many use hawala-like networks to send money or gifts to their friends and relatives residing in Asian, African, and Middle Eastern countries. Given the large number of ethnic groups that make up the U.S. population and the continuous waves of new immigrants from many parts of the world, this country has seen inevitably many IFTS transactions.

We must reject the earlier understanding of hawala as “money transfer without physical movement”. It is erroneous to regard this as a feature unique to hawala. As outlined earlier, the value transfer and settlement methods employed by hawaladars are not very different from other fund transfer methods, such as international (formal) banking, money changing businesses and wire transfer companies. What characterizes hawala is informality, higher reliance on trust, a frequent lack of records intelligible to an outsider, and the use of networks that are in part illegal here or, most frequently, in some foreign countries.

While it appears that most clients of IVTS make honest money and try to assist their extended families, criminals also use these networks to launder dirty money, finance terrorism, make illicit payments, and commit other offenses, such as tax evasion and customs fraud. Dealing with hawala operators and networks thus represents a serious challenge to U.S. law enforcement agencies. In general terms, the difficulties revolve around the detection of illicit hawala operations, investigation and infiltration, as well as successful prosecution and enforcement of the law. In brief, the ways in which investigations get complicated include the following:

Much like other financial service providers:

- Hawala can hide criminal activities;
- Legitimate commercial activities can shield hawala operations;
- Both of these can be obscured by “benami” (false name) or nominee relationships;
- Another layer of difficulty is added when transactions involve the use of more advanced technology (e.g. the internet) or funds go through “correspondent” and “pass through” accounts;
- Additional layers of difficulty develop when such transactions go through national jurisdictions without transparency-enhancing bank secrecy laws or inadequate money laundering legislation;
- Given that many IVTS involve commodity trade or smuggling, a further hurdle is raised when transactions pass through jurisdictions with porous borders or cash-based economies.

These factors necessitate more resources than usual and excellent cooperation among agencies within the U.S. and internationally. While discussing the issues posed by hawala-type of operations, it noteworthy that the specificity of hawala has been generally exaggerated. The core of the problem is that law enforcement has never before focused on this type of transaction and the ethnic groups involved. They therefore need time and resources to develop the required expertise, understanding and intelligence for better results. At the same time, the combination of difficulties unique to traditional IVTS, which control agencies encounter in other types of transnational crime, render the task particularly challenging (see Table 3 on common and unique hawala issues).

<b>SIMILARITIES WITH OTHER CRIMES</b>	<b>UNIQUE FEATURES</b>
Benami/nominee relationships	Trust among clients and operators
Use of codes Messaging v. funds movement	More asymmetric treatment around the globe
Lack of records	Lack of records in parts of transactions route
Mixing of business	Frequency of mixed business for operators
Too many records	Use of illegal networks for settlement
A lot of honest money goes through it	
Distrust of authorities	
Linguistic difficulties	Specific to terrorism
Cultural specificities	Ideological/religious commitment

Table 3: Common and Unique Challenges Posed by Hawala

There are many varieties of hawala transactions and ways in which the accounts are balanced (see above). Certain characteristics that appear to be rather common create obstacles to law enforcement efforts: a) non-standardized or absent record keeping and know-your customer type of practices which block investigative trails, b) the frequent fusion of hawala with other business activities and c) the difficulty of knowing for sure whether a policy relative to hawala is actually producing the intended effects. While many of the challenges posed by hawala are common with those encountered in the control of drug trafficking and other transnational crimes, some are unique or more pronounced. However, even though some types of difficulty are common, such as cultural and linguistic issues, law enforcement agencies have not yet had the time to focus on these networks and develop the necessary expertise and human intelligence to be effective. In addition, the combination of these challenges in an environment of relative fear and lack of trust make the task even tougher.

### **Lack of Record keeping and Potential Difficulties in Deciphering Records**

Given the centrality of trust in hawala networks, both the records kept and the processes of ultimate client identification are often minimal. In some cases, record keeping by hawaladars is mostly a short-term exercise that lasts until the accounts with counterparts are balanced.

Transparency is essentially absent; most transactions are conducted by telephone, fax and email. In the U.S., Europe and the UAE, IVTS operators frequently keep details for long periods of time in computers and/or hard copy. This, however, is not the case in countries where computer technology is not widespread or in jurisdictions that have outlawed hawala-type of transfers. Following the introduction of regulations on all Money Service Businesses (MSBs) in the U.S. and the requirement to register and obtain a license, it may be that at least some U.S.-based non-complying hawaladars would not keep records either<sup>8</sup>. Whenever one hawaladar along the chain of transactions does not keep records, the money trail is disrupted.

In some cases, Internet or telephone banking may be used for the payment of money to ultimate recipients. This is a double-edged sword. It may create some trail for investigators, but at the same time, hawala transactions may get lost in the massive numbers of daily transactions going through the wires, particularly as IVTS transactions may be commingled with other business.

Hawala ledgers are often insubstantial and in idiosyncratic shorthand. Initials or numbers that are meaningful to the hawaladar are useless, if they reveal nothing about transactions, amounts, time, and names of people or organizations. Personal ledgers are often destroyed within a short period of time, especially in countries where hawala is criminalized. In some cases, particularly when hawaladars know their clients are breaking the law, no notes or records are kept at all. In other cases, hawaladars may serve customers without asking many questions about their true identity, the origin of their money or the reason for the transfer. In such cases, even if operators decided to cooperate with authorities, they would have no knowledge or useful information to share.

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<sup>8</sup> Compliance is in many instances made impossible by some state licensing rules – e.g., bond or capitalization requirement of \$500,000 or even \$1 million are unaffordable by small shopkeepers offering a hawala service to their community.

Without records, paper trail or some documentary basis, there is very little investigators can pursue and may thus face a dead end in their efforts to build a case against a hawala operator or his criminal customers.

### **Too Many Records**

The opposite type of challenge is likely in some cases or countries through which hawala transactions take place. It is clear that, contrary to conventional wisdom, some hawala operators do keep records even after the accounts have been balanced with counterparts overseas (they can go back for many years).

A characteristic of both hawala and other IVTS is that they are not monolithic networks employing identical and standard methods. Various ethnic groups and operations of varying sizes and amount turnover employ diverse channels and record-keeping. So, while some IVTS may have no records or undecipherable ones, other IVTS operators keep detailed ledgers (see Table 4 below). When traditional IVTS send legitimate funds overseas, one is very likely to find extensive information kept by the operators. The same seems to apply to IVTS operations that mix some illicit funds with legitimate ones and/or with other, trade-related transactions.

<b>HAWALA WITHOUT (HELPFUL) RECORDS</b>	<b>HAWALA WITH TOO MANY RECORDS</b>
Illegal operators	Legitimate operators
Illegal transactions	Mixing legal with illegal funds/transactions
Operators in jurisdictions restrictive of IFTS or those outlawing traditional IFTS	Operators in Western countries and countries allowing free capital flows

Table 4: Differences in Record-keeping Practices

In many hawala cases in the U.S., Europe and the UAE, investigators end up finding masses of records, ledgers or notes kept by operators. The details include the sender, recipient, amount, exchange rate, commission charged, date and balances with counterparts. Often, some records are kept in ways hard to decipher without the cooperation of those who created the records. Sometimes the notes are kept in foreign languages or use initials and codes.

Recall the funds from a hawaladar's cash pool may go to one country or account, while the payment instructions follow a different path. For example, one may wire funds to Germany, where a partner or the purchaser of the funds can use them to buy goods for export to India. He will use his profits for the payment of individuals in India. In the meantime, the payment instructions would have been sent to a different person in India. In this way, investigators need to have information both on the payment instructions and the movement of funds. This is a problem we may encounter in the management of correspondent accounts of formal banks. Not even sophisticated software can currently monitor the messaging and the movement of funds through formal financial institutions. This task is even harder when it comes to hawala.

In other instances, the interface includes third party accounts of individuals or companies within the same country or a number of other countries. "Benami" or nominee accounts effectively stop the money trail, as we know from investigations of banking, financial, and trade-related misconduct.

In the end, most of the paper trail might surface, but it becomes a difficult task to interpret it and reconstruct it accurately. The task of putting everything together both for investigators and, ultimately, jurors, will also get more complicated as the production of all the documents may require the cooperation of hawala operators or controllers in other jurisdictions.

### **Mixing of Various Businesses**

Hawala is rarely an independent or separate business. The transfer of clients' money may be combined with gold, diamond or other commodity deals. Hawala and criminal activities can be commingled and concealed in the mass of other, ordinary and non-suspicious transactions. Hawala has interfaced with antiques shops; banks; brokerages; fabric stores; importers and exporters of computer, medical and other equipment; book traders; shell companies; souvenir shops; and telephone/internet shops .

Thus, false invoicing of exports or imports can help hawaladars balance their books. Under-invoicing by \$20,000, for instance, "sends" this amount to the importer of computer equipment, who will make profits higher by this amount upon resale of the goods. If the amounts to be settled are not excessive, they can easily "disappear" in otherwise legal trade. A \$20,000 "mistake" in a \$1-2 million trade is unlikely to raise eyebrows, even if detected.

The detection of under-valuation or over-valuation of goods often requires inside information and may be impossible even if Customs and Border Patrol undertakes sample checks.<sup>9</sup> (i.e. if medical, computer and other equipment contains chips, drivers or updated software versions, these can only be discovered if the equipment is opened up and subjected to the most thorough inspection).

Other variations may mix hawala with travel businesses, wire transfer services, grocery stores, antiquity trade, farm exports, jewelry shops, etc. In other cases, “payments” are made for goods that are not delivered, incorrectly described in the invoice or returned after delivery is recorded. The payment does not appear to be connected to any unusual or suspicious deal. In South Asian cases, gold movement across national borders used to be especially linked to hawala either as a method of balancing accounts or as a reason why hawala transfers are made. In more recent times, the trade in precious stones seems to be emerging as more important.

Proving criminal offenses and intent is more difficult when commingling takes place. Even trained professionals will find it hard to detect an IVTS operation that wishes to remain hidden (whereas up to now it has been comparatively easy to find the right person in an ethnic community to help send money overseas). For businesses operating with a lot of cash or involving high turnover, it is very easy to hide hawala deals. They can create “black holes” domestically and overseas by withdrawing cash pooled by hawaladars, depositing it in different accounts at various intervals and financial institutions (banks, brokerages, etc.), and/or using it to purchase commodities to be traded here or internationally. It is virtually impossible to match cash withdrawals with other deposits and trade transactions, when the amounts are comparatively small. The point is that, whereas traditional IVTS have not been really ‘underground’, they can easily shield their operations, should they perceive a need and demand for it.

A related challenge is targeting illegal acts perpetrated through hawala without affecting the numerous innocent customers who send honest money back home to their family, without unduly disrupting trade, government and NGO activities helping to rebuild regions in crisis or harming legitimate enterprises. Keep in mind: the overwhelming majority of traditional IVTS clients are sending and receiving honest money. Holding up or freezing those assets causes

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<sup>9</sup> Note, however, that if medical, computer and other equipment contains chips, drivers or updated software versions, these can only be discovered if the equipment is opened up and subjected to the most thorough inspection.

substantial collateral damage and undermines efforts to build an effective alliance against the illegitimate or illegal.

In other cases, hawala businesses interface with financial institutions (e.g., they may have bank or brokerage accounts, bureau de change, offer telephone and fax services, send wires, engage in real estate deals). This type of interface is reminiscent of the difficulties investigators face when they deal with correspondent or “pass through” accounts, because it is hard to get information on the real beneficiaries of transactions (in “nested” correspondent relationships, US banks do not know who their ultimate customers are at all). For example, a currency exchange dealer in a given country could possibly send and receive wire transfers for a hawala customer via one or two foreign banks. When the funds are booked into correspondent accounts at U.S. banks, identifying the parties to a given transaction is an onerous or even impossible task. The same type of challenges arises if accounts are held by hawaladars or their clients in private banking departments. In those cases, the U.S. correspondent bank is effectively the equivalent of a modern hawaladar. Given the gigantic capital flows through these accounts on a daily basis, investigators cannot hope to track down specific amounts or clients. Even if they did, by the time they would succeeded so, it would likely be too late to seize the money or prevent a terrorist attack.

In such cases, it is important for bank officials, credit card companies, brokerages, money exchanges, transmitters, etc. to be familiar with illicit IVTS patterns, recognize them and report them as suspicious. However, such professionals are frequently unaware of such patterns or indicators of abusive hawala or modern IVTS. They therefore do not detect nor report suspicious transactions and patterns to authorities for further investigation.

Just as there are plenty of connections involving legal businesses, there is room for interfacing with criminal enterprises as well. By lending itself to the laundering and hiding of the proceeds of criminal activities, hawala and other IVTS raise hurdles in efforts of law enforcement to identify the beneficiary of amounts that are being transferred and to follow the money trail to the ultimate destination. Therefore, understanding IVTS fully will require a better understanding of transnational crimes, an area that has not been well researched so far. Conversely, studying IVTS more in depth can also contribute to better understanding of transnational crime.

## **PROBLEMS ASSOCIATED WITH THE CONTEXT OF HAWALA OPERATIONS**

### **Linguistic Issues**

As with drug trafficking and other transnational crimes, detection or recognition of hawala is harder because the actors involved are from foreign countries and speak languages law enforcement agents may not understand. Even after the extensive publicity of hawala in the press, many agents do not know to what the word refers. This can also complicate communications, contacts and liaising with foreign counterparts. Case in point: the term has been overused recently, to the point that any unusual transactions of foreigners are regarded by many as “hawala”. Language issues raise hurdles in communications with suspects, identifying suspicious transactions and interpreting evidence.

### **Cultural Differences**

Closely linked with linguistic challenges are cultural specificities of targets of investigations, their clients or victims, and regions through which they operate. When hawala ledgers are found, it may not be impossible to understand their contents and underlying transactions. The cooperation of hawaladars is essential for deciphering their records (as with cases of accounting fraud and the records of drug traffickers). Such assistance may not be forthcoming, however, if there are ethnic, cultural or other sensitivities that investigators ignore or misunderstand. Western agents often under-estimate the value and significance of trust on which hawala relationships and operations are based. A tendency to make ethnocentric assumptions about the way hawaladars or their clients think, calculate and prioritize, may undermine investigations and the chances of successful enforcement/prosecution. Witnesses may be turned off by cultural insensitivities and perceived discrimination, while operators may be less inclined to cooperate and inform on co-conspirators.

Cultural misunderstandings and ethnic differences also reduce the chances of successful infiltration efforts and under-cover operations. The distrust that can sometimes build up between a given (ethnic) group and those around it can be quite powerful, counter-productive and difficult to overcome.

On the other extreme, over-concentration on particular ethnic groups or cultural practices may divert attention from any possible intersection or collaboration across ethnic lines. There were

cases, for example, in which persons of Arab ethnic background have interacted with Chinese (Hong Kong) unregulated remittance companies (sometimes called “underground banks”), or Latin Americans have transacted through Asian jurisdictions and banks. Some money to assist in the first attack on the World Trade Center may have moved through a black market exchange broker in Venezuela.

Moreover, within the same country, middlemen may provide the required trust to bring together actors from different parts of the Middle East, Asia or Latin America. Just as various ethnic groups have been known to form ad hoc alliances for particular criminal operations, such as drug trafficking, links can potentially connect hawala operators with those involved in other IFTS (e.g., BMPE money potentially going to the Middle East before ending up in South America). Even less conspicuously, one individual may simply know well and trust someone of a different ethnic group who offers to use his own ‘connection’ to send some money to a third party. As agencies are busy focusing on a given geographic area, ethnicity or hawala variety, inter-group criminal partnerships could go unnoticed.

A step toward overcoming such impediments would be to develop individual and institutional knowledge, understanding and expertise, all of which strain resources and can only be achieved with patience and over time. Given the pressure to act against terrorists and suspected associates or facilitators, there is a risk that actions and measures may need to be taken before the necessary competencies are developed. As a number of investigations are currently underway, it would be extremely beneficial to systematically gather all available evidence, analyze it and provide more accurate investigative and prosecutorial tools to those on the front lines, such as fine-tuned indicators of IVTS and criminal use. This will go a long way toward streamlining investigative work, saving time by reducing unnecessary pursuits and innocuous use of IFTS, avoiding collateral damage and tensions with ethnic groups that can otherwise be enlisted in the fight against terrorism, and leading to easier prosecutions of serious offenders.

### **“Benami” Accounts**

Another obstacle to investigations is raised by benami, false name or nominee accounts, which are culturally accepted in ethnic groups that engage in hawala. When the true beneficiary of a transaction is not the person under whose name the transaction takes place, it is very hard to identify the owners of criminal proceeds and people who engage in illegal activities. This is a

problem encountered in cases ranging from drug trafficking to corporate crime and white-collar offenses. In the same fashion, there have been repeated incidents of money laundering and terrorism funding that involved benami transactions (in some cases, accounts may be held by a lawyer, accountant, friend, or even persons unaware that someone else is using their name). For example, a bank account is opened by someone conveniently located near the leader of an organization that engages in terrorist activities. Money is sent and received through this account, the holder of which loyally passes the money on to (or receives it from) the terrorist leader. In this way, the terrorist organization shields its financial affairs or merges them with those of apparently unrelated persons. Sometimes, the owner of a benami account may be simply fictional, making the tracing of the beneficial owner impossible.

### **INTERNATIONAL COORDINATION AND COOPERATION**

In general, the success of law enforcement efforts to detect, understand and solve cases involving hawala and associated complex settlement processes depends to a substantial extent on information and evidence that can only be provided from outside a given jurisdiction or another country. Yet, investigators and prosecutors report that they often face uncooperative counterparts overseas. Similar complaints are voiced overseas about U.S. agencies (personal interviews). Repeated requests for mutual assistance and information or access to documents often go unanswered. Such difficulties are, of course, multiplied when more than two countries and several types of businesses are involved. U.S. federal level regulatory authorities warned against domestic authorities pursuing unnecessary fishing expeditions with foreign counterparts that would only risk souring working relationships.

It is also common to find that brick walls block domestic and international efforts to piece together trails associated with hawala activity. For example, numerous wire transfers from an entity in the U.S. may accumulate into a central pooling account in another state, in the United Kingdom or in the United Arab Emirates. The subsequent disposition of the funds (e.g., possible cash withdrawals followed by commodity purchases and/or deposits made in intervals at other financial institutions) may be impossible to trace without a further understanding of the actual workings of specific networks, foreign financial practices and the assistance and guidance from foreign law enforcement and regulatory counterparts.

When hawala operates through jurisdictions with strict secrecy regulations, the investigative task is further complicated and cooperation more rare. Bank and corporate secrecy and lawyer-client privilege make the investigators task unenviable. Sometimes, a vicious circle prevents law enforcement agents from completing their task: in order to obtain information from such jurisdictions, evidence of wrongdoing is required; however, access to information in those jurisdictions is critical in obtaining that evidence in the first place. In this light, inter-agency and international cooperation becomes even more crucial.

### **DIFFICULTY OF POLICY ASSESSMENTS**

How can we tell whether our policies are working and are having a substantial impact? To the extent that the primary concern is about the funding of terrorism or facilitation of other crimes, appearances may be deceptive. For instance, if some IFTS activity is reported to be declining, this may not be necessarily good news. That is, former hawala dealers may be switching to alternatives (for example, commodity-based value transfers and other IVTMs), with which law enforcement agents are likely to be even less familiar. They may be aware of under- and over-invoicing practices, but private investigators and law enforcement agents have also encountered more sophisticated schemes, such as trade diversion, whereby the perpetrators engage in no eyebrow-raising activities.

### **INTERNATIONAL LEGAL AND ADMINISTRATIVE ASYMMETRIES**

As with other types of misconduct, laws and regulations about hawala vary from country to country. A difficulty peculiar to hawala is the wide range of legal approaches. Countries from which immigrant communities remit money to their homeland generally treat it as a matter of regulation and scrutiny, much more so after 9-11. Indeed, in the past, hawala was regarded as a means of transferring money that raised problems only when it facilitated the commission of financial or other serious crimes.

Even within the group of countries hosting immigrants and allowing free flow of capital, there is no consensus about how to deal with hawala.. Some countries outlaw all hawala transactions; other countries attempt to regulate hawala by requiring registration, licensing, reporting of suspicious transactions and record-keeping for certain periods of time. Still others leave hawala completely unregulated and free. Among those countries that introduce regulatory

requirements, the amounts above which hawaladars are obliged to keep records and report suspicious transactions to authorities vary.

In the United Kingdom, for example, on November 12, 2001, anti-money laundering regulations came into force, which require money service businesses, such as bureau de change and money remitters, to register with Her Majesty's Customs and Excise. In addition, Customs was given new powers to enter and inspect such businesses, including hawala, and other IVTS to ensure compliance with the rules. Before this legislation, the main legal instrument regulating money transfer businesses was the 1993 Money Laundering Regulations. Theoretically, unregistered IVTS were subject to the 1993 regime. However, in practice no enforcement action would have been taken without other substantive offense, such as drug money laundering. This, incidentally, continues to be the focus of law enforcement efforts in the UK to this date.

In Saudi Arabia, where there is formal hawala, people mostly use the term 'hundi' to denote informal money transfers. Because of the strict enforcement of Saudi laws prohibiting hundi practices, most expatriates apparently send remittances through bank channels, the services of which have improved substantially in recent times. Nevertheless, from case reviews it appears that hawaladars operating mainly in South Asia countries do have counterparts in Saudi Arabia.

In a similar fashion, Japan authorizes only banks to engage in funds transfers and criminalizes other methods. Because illicit transfers there often take place through banks, Japanese authorities have fine-tuned guidelines to financial institutions for better reporting of suspicious activities to the Financial Intelligence Office.

Australia, Germany and Hong Kong stand out as immigrant-hosting jurisdictions with regulations pre-dating 9/11 and which apply to hawala and other money transfer businesses. They all require licensing of businesses that remit money. Australia's Financial Transaction Reports Act 1988 also requires remittance agents report suspicious transactions and cash transactions over \$10,000 to the authorities. AUSTRAC, their equivalent to FinCEN, has also engaged in an outreach program to inform remittance agents of the rules and their obligations thereunder.

Hong Kong enacted legislation in June 2000 requiring money transfer agents to register with the authorities, establish the identity of their customers and keep the records of transactions over HK\$ 20,000, keep those records for six years, and report suspicious transactions. An outreach program was also part of the strategy, including the publication and distribution of guidelines and notifications to those concerned (including travelers who might act as money couriers).

In Germany, under legislation enacted in 2000, providers of financial services “commercially or on a scale which requires a commercially organized business undertaking”, must obtain a license from the Federal Banking Supervisory Office. Money transfer businesses (including “non-account related” money transfers) and foreign exchange bureaux are considered as financial services requiring a license.

Given that these approaches have been applied for a period of time, it would be instructive to examine them in some depth to evaluate their relative successes and difficulties. Tall countries could draw on these experiences and construct policies that benefit from the lessons learned overseas. On the other hand, countries on the receiving end of workers’ remittances are sometimes jurisdictions with controls on capital flows and currency exchange rates. Hawala enables not only expatriates to help their families in the homeland, but also tax evasion, evasion of exchange controls, capital flight, and corruption. Combined with mis-invoicing and gold or precious stones smuggling, the capital flow can actually be negative for such regions. As hawaladars allow for the draining of financial resources and deprivation of highly valued foreign currency in those countries, hawala has been criminalized for some time.

In India, the Foreign Exchange Management Act (FEMA), enacted in 2000, replaced the Foreign Exchange Regulation Act (FERA) of 1973. FERA criminalized the practice of hawala, which carried penalties of up to three years in prison for amounts less than 100,000 Indian rupees, seven years in prison for higher amounts and fines up to five times the amount involved. Under the FEMA, hawala is a civil offense carrying a penalty of up to three times the amount involved. Prosecutions are now more difficult due the general lack of evidence. The money seized can be confiscated under both Acts.

In Pakistan, money transfers can only be conducted by banks, although the State Bank announced in the summer of 2002 that it intends to authorize money changers to also engage in fund transfers. Under the proposed plan, some money changers may be issued Exchange Company Licenses. Regulatory details are not yet available.

As has been the international experience with money laundering generally over the past decade, it is likely that such legal asymmetries impede cooperation among law enforcement agencies, evidence gathering, witness production, etc. (The same potentially holds true regarding differences in state regulatory frameworks within the U.S.). However, international differences in laws, regulations and culture are not accidental or

random. They reflect differing socio-economic and political realities. Thus, trying to harmonize rules and maximize genuine international cooperation can only be achieved when such contextual asymmetries are also reduced or at least recognized. For example, if banks are non-existent, inefficient and too expensive to serve low-income customers or when the physical security of business people is threatened in a particular area, it can be expected that the enforcement of anti-hawala measures may not be strict. Law enforcement officials in that area are likely to sympathize with hawaladars and their clientele.

This legal asymmetry along with the informality characterizing hawala can also lead to unsanctioned, unregulated and often murky settlement methods. If hawala is a crime on one end of a transaction, the settlement of account between hawaladars and the payment or receipt of money can be not only informal and invisible, but also outright criminal. This interface with transnational crime means that settlement methods can only be understood, when and if the related offenses are cleared. Knowing the details of these ‘underground’ settlement methods is often an indispensable step toward establishing the identity of the ultimate recipient or the true sender of value and funds.

One way of resolving the international regulatory lack of consensus (which also reflects the relative lack of understanding on what hawala is and how it really works) would be to consult with the users, operators and beneficiaries of the system. It is quite possible that such a process will lead to regulatory arrangements with which this sector will be comfortable and comply with. Surprisingly, no country has sought to do this, not even the United Arab Emirates, despite the fact that the UAE Central Bank is keen on issuing regulations on this sector. Following the Abu Dhabi conference on hawala (sponsored by the UAE Central Bank), this country seemed ready to provide a lead in introducing a regulatory regime that would take into consideration the views and interests of hawaladars, their competitors, and clients of hawala. This would be very important given that hawala is practiced heavily and freely there and because of Dubai’s apparently central role in the settlement process. It would be interesting to see how rules conceived by the Central Bank, which are expected to be introduced in the near future, might affect hawala trading in that region.

In short, all of this renders hawala-related investigations longer, more difficult and costly. Hawala frustrates the investigation of scores of serious crimes. At the same time targeting certain hawala operations/networks without causing substantial “collateral damage” to innocent users and racial/ethnic animosity can become a rather delicate and tricky policy issue. In order to assist

controllers in this difficult challenge, the following indicators of hawala use and abuse have been developed to serve as guidelines.

#### **INDICATORS OF USE AND ABUSE**

Two sets of indicators have been developed so far. The first one points to the operations of IVTS networks, while the second one draws attention to the likelihood of criminal abuse of IVTS. The main emphasis so far has been on traditional IVTS rather than the more contemporary types.

#### **Indicators of IFTS Activity**

1. Checks, money orders, cash deposited into a bank account
2. High turnover in bank account of low-income earner
3. Wire activity out of a bank account
4. Money sent by trader to companies not dealing with same kind of business
5. Cash shipments
6. Inexplicable currency rate fluctuations in local market (indicating large payments in foreign currency)
7. Suspicious Activity Reports (SARs) (many agencies routinely and systematically review SARs filed by financial institutions).

In the post 9-11 context, as many law enforcement agents are very keen on acting against potential terrorist targets, it is important to ensure that we all understand that once a hawala or other IVTS is identified, it does not automatically mean cracking a crime. It may well be that most or all clients are sending honest money to friends, relatives and associates in parts of the world for which IFTS is best vehicle.

#### **Indicators of Criminal Abuse**

More important to controllers are red flags for misconduct. The following list of indicators of criminal abuse fits well the pattern of money laundering operations observed over the years. It is emphasized that they do not prove criminality, but rather constitute indications that something about a given business model or set of transactions is not right. None of them

provides a “smoking gun”; it is the combination of several of them that should draw the attention of controllers, who should look for additional evidence.

1. Different recording methods for some clients
2. No recording of certain (large) transactions
3. Large daily sums transferred
4. Large sums from single customer
5. Different collection methods
6. Transactions divergent from usual pattern (e.g., very large amounts once in a while)
7. Transfers to traders or companies engaged in a very different kind business
8. Transfers to accounts of individuals or companies involved in illegal activities
9. Different commission or fees charged to ordinary clients

A bit of background information concerning the evidence and thinking that guided the development of the indicators of abuse is in order. This process was based on analysis of numerous cases, in order to determine what fits the legitimate hawala picture and what does not. It did not stop there, however, especially given the relatively small number of cases that came to light, especially before the events of 9-11. During interviews, hawaladars, their clients, and law enforcement agents who handled hawala cases in the past were asked how they would identify illegal hawala business. All the evidence was analyzed against academic and policy literature as well. More specifically:

[1] In the absence of a regulatory prescription and given the informality of hawala, each operator tends to have some idiosyncratic ways of keeping records of transactions. There are some general “templates” that are more frequent than others, but for the most part almost all hawaladars make a some notes to make sure no mistakes are made and facilitate account reconciliation. As stated previously, the length of record retention varies widely. varies widely.

Once a hawaladar has developed his or her own method of keeping the books, there has to be some compelling reason to change the routine. Therefore, if some clients’ requests or transactions are recorded differently, one should take a look and find out what is the rationale behind it. If the difference is that no real names or any names are written down from the

remitting end, this suggests that these clients require more confidentiality or anonymity than others. Less information on some transactions may mean that there is something illegal to hide.

[2] In a similar way, if some transactions are left completely unrecorded, it may well mean that there is some underlying illegality. This is particularly significant if large amounts go through the hawala network without documentation. After all, mistakes and errors do occur. Once in a while, someone is not paid the correct amount or at all. It is the records kept by hawaladars that help them correct the errors. The higher the amounts and the more important the clients, the stronger the need to make notes of transactions to ensure a smooth operation and satisfaction of the customers. Leaving those unrecorded or marked with codes or initials suggests again that the hawaladar wishes to hide something away.

[3] Large daily turnover was emphatically reiterated by hawaladars as the most important “red flag”. It is one thing to see substantial amounts change hands in a money changer’s premises in Dubai (where a lot of money gets laundered too) and quite another to see it in the office of a retail textile store or a travel agency. This is a very strong indicator not merely because some hawaladars themselves would say so. It also makes sense, because there is simply not enough legitimate money in need of international transfer. Given that all sides constantly use cash pools to make payments on behalf of hawaladars, only the excess amounts from a given country would have to be actually transferred. In other words, the money wired out of the United States does not represent all the money that workers and other wish to remit overseas, but only a portion of it. The cash pool to which their hawaladars contribute is used in the meantime for payments within the U.S.. If hawaladars keep transferring money abroad, this means there is a net outflow of funds

Where would the money be going to, if the traditional clientele comes from the South Asian community in the U.S.? Worker remittances would go from the U.S. to the homeland, but this is but one source of hawala cash pools. There are traders, businesspeople, tourists and others who make use of hawala services. Given the political and economic situation in South Asia, one would expect more money wishing to come to the U.S. rather than leave. So, large outflows can indicate that money goes out one door in order to come through another, which is what money launderers do to integrate dirty money into the economy and obfuscate the dirty sources of it.

The question is really how much legitimate traffic is there and how much of it is going through hawala. According to an International Labor Organization (ILO) publication, global

remittances were estimated at \$70 billion in 1995 (Puri and Ritzema, 1999). However, it will help put the current case in perspective, if we concentrate on India and Pakistan.

According to the National Bank of Pakistan, a total of \$913.5 million of remittances went to Pakistan through official channels (see Table 5 for the figures on 1990-2000).

Table 5: Workers' Remittances to Pakistan, 1990-2000 (in millions of U.S. dollars)										
1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
1897	1942.4	1455.9	1252.5	1238.5	1093.4	1317.7	1227.3	1237.7	875.55	913.5
Source: National Bank of Pakistan, 2002										

In fact, according to calculations of the International Monetary Fund (IMF) and the World Bank, only about half of the total transfers goes through unofficial channels, while the percentage is much lower for India (10 percent; see Table 6 below). The IMF calculation receives some confirmation from Pakistani sources reporting in Islamabad The News in English (4th March 2002) that official remittances have increased to an annual rate of about \$2 billion. As the report states, "This sudden flow of workers' remittances was the result of investigations against moneychangers in the United States and United Arab Emirates on suspicion of terror related flows through hundi or hawala system." As hawaladars came under scrutiny, most if not all, legitimate remittances switched to the less convenient and more burdensome banking system. This switch allowed us to see more accurately the extent of the hawala market.

Table 6. Estimated Share of IFTS in Total Private Transfers, 1990-2000											
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
India	0.22	0.29	0.11	0.11	0.11	0.12	0.12	0.10	0.10	0.10	0.10
Pakistan	0.41	0.42	0.41	0.41	0.41	0.41	0.41	0.43	0.57	0.50	0.50
Source: forthcoming IMF/World Bank study											

Hawala is by no means the only unofficial method of getting money from the West to India and Pakistan. We have seen that there are several methods available to expatriates:

Hawala is by no means the only unofficial method of getting money from the West to India and Pakistan. We have seen that there are several other IVTS available to expatriates:

- By Courier – someone who does this all the time or a trusted friend visiting home. This can be done openly or by hiding the money in the luggage.
- They can take it themselves in the form of either cash or travelers checks. According to some estimates, more than a quarter of unrecorded remittances to Pakistan take place in this way (Kazi, 1989).
- They buy goods, such as clothes and consumer items, and sell them back home to encash their value. These three methods seem to be particularly common in Pakistan, the Philippines, Sudan and Egypt (Puri and Ritzema, 1999).
- They can send gifts with friends, intermediaries or carry them themselves. Gifts can now be sent through internet-based intermediaries too. These can be called remittances or payments in kind. The goods may be kept for personal use or sold in the black market for their cash value. It has been estimated that 11-20% of cash transfers in countries like Pakistan and the Sudan are taking place through in kind payments (Puri and Ritzema, 1999).
- Alternatively, they can use mis-invoicing of exports from India and Pakistan, which is another means of sending the money home through traders. This method can be used without the intermediation of hawaladars, especially if someone engages in trade himself or has friends who do so.
- They can use their bank account at home and allow a friend back home to withdraw money by using their debit or credit card.
- Finally, banks can be used also for unofficial remittances, as banks use correspondent accounts overseas, in which they can receive money on behalf of certain clients. Such funds may be easily commingled with financial transactions on behalf of the bank, so that the identity of the clients and the funds transfer can be hidden from anyone's view.

In short, there are plenty of informal and unofficial alternatives to hawala. In this light, whenever we see millions of dollars being wire transferred out of the U.S. daily, such operations seem too disproportionate to be totally legitimate.

It may be suggested that remittances of workers is only a small part of the picture. Trade is more important. Yet, one can ask how much trade needs to be financed through hawala these days? Clearly, none of the intra-European trade. Interviews with South Asian and other businessmen further suggest that none of them use hawaladars. Moreover, they do not always use banks. They would rather travel to the place of purchase with cash, buy the goods and drive them back to their home. So, intra-European settlements do not have to go through IVTS channels, if they are legitimate. The same applies to trade with other Western countries, such as Canada, the U.S. or Japan, where bank facilities are efficiently and inexpensive.

Even if we accept that there is too much small-scale business resorting to hawala, there is no reason to expect that there would be so many more imports from the U.S. than exports from Pakistan and India that need to be paid for. More importantly, once we consider the political situation, including the atomic tests, and the economic conditions in South Asia, then capital flight is likely to generate outward rather than inward fund flows. Add the need of corrupt officials and tax evaders to evacuate their money, and you find that the large net outflow of funds from the US or UK becomes suspicious.

One can still argue the funds do not go back to these countries, but get invested in stable jurisdictions. This is precisely why this set of transactions raises the suspicion of money laundering. Money laundering would simply not involve the return of high amounts to societies facing economic or political challenges (even though the life of luxury some traffickers wish for themselves and family back home suggests that some amounts will go there). Hawala cases studied do not provide evidence that such funds are repatriated, but that they possibly stay somewhere in the West. That is, they get laundered and recycled. In money laundering jargon, the suspicion is that hawala is used for placing the money into the financial system, layering it so that the original source is difficult to find, and allowing for the integration of it into legitimate business<sup>10</sup>.

[4] For similar reasons, large sums from a single customer should raise eyebrows.

[5] Why would different collection methods draw anyone's attention? Again, there is no economic or cultural rationale for receiving the money in different ways. If some clients wire

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<sup>10</sup> Caution is warranted, however, as agents and sub-agents of hawaladars may collect remittances that, in the aggregate become quite substantial for a single hawala operator. Cases of consolidation may need to be looked at somewhat differently.

their remittances and send a check or deposit their money directly to IVTS-controlled accounts, why would others, including legitimate traders and those with large amounts, not do the same?

In a British case (Regina v. Basra et al. 1991), some clients would send up to seven hundred thousand British pounds per day by courier to the hawaladar, who sent other couriers to pick up the cash in strange places and did not know in advance how much money he was about to receive. Such a case raises several questions: Why take the risk of physically moving hundreds of thousands of pounds daily from place to place? Why deliver the money in fast food and other strange places? Why incur the additional cost of couriers? Why send the money to an IVTS operator, who is also charged by the bank and who also charges his clients for his service? What is the economic benefit of engaging in this?

[6] Transactions departing from a hawaladar's usual business pattern should also raise some suspicion. Expatriates keep sending their remittances in relatively regular periods. Overall, there should not be substantial fluctuations with the exception of instances like those generated by the closure of BCCI. Therefore, very large amounts sent only once in a while may not be explained by ordinary and legitimate transactions of regular clients.

[7] A hawaladar's transfers to traders or companies engaged in very different kinds business suggest either this is a legitimate third party settlement or the transaction is designed to hide something or someone.

[8] When funds are transferred to accounts of individuals or companies involved in illegal activities, the authorities ought to take a closer look at the entire transaction.

[9] Practices making no commercial or economic sense are usually indicative of criminal activity (even though one cannot rule out sloppiness, negligence or ineptness).

[10] Finally, substantial differences in the commission or fees charged to ordinary clients as compared with select other customers who are charged a higher rate. The higher rate may reflect the understanding of a hawaladar that the money or transaction is not entirely legal. Due to the higher risk the hawaladar runs by facilitating such deals, the premium charged is expected to be higher. When hawala services are much more expensive than the alternatives, they should raise suspicions of illegality.

### **THE NEXUS WITH SERIOUS CRIME AND TERRORISM**

The growth of trade and increased mobility of people (legal and illegal) has created the infrastructure for truly global networks settling up through third parties quite efficiently and cost-effectively. Importantly, there are instances of cross-ethnic collaboration with respect to both legitimate and criminal value transfers, including funds destined for the support of terrorist groups. In addition, the success and efficiency of IFTS like hawala have inspired imitators outside Asia (e.g. Nigerian and Surinamese groups).

As far as Indian authorities and other sources are concerned, most if not all the money funding militants in the North of the country moves through hawala. Investigative reports and interviews with controllers and law enforcement officials in India confirm that hawala is the preferred method money transfer in the sub-continent.

Pakistani officials (high and low level) share this opinion about terrorist actions in Pakistan. To this chorus can be added the voice of the United Nations Monitoring Group regarding Sanctions on Afghanistan and the financing of al Qaeda, which reported that a large proportion of the Taliban resources moved by hawala channels through Dubai (U.N. Monitoring Group, 2002).

In the course of this project and work conducted for FinCEN, numerous cases of hawala and terrorist finance were encountered. Some are summarized in the appendix (see cases 27-29, for example). Some can be easily developed into case studies providing further insights, even though the mechanics and modus operandi is exactly the same as with ordinary hawala. The one notable difference is that militant groups sometimes resort only to very trusted or especially dedicated hawala operators for security reasons. At the same time, it is also noteworthy that Indian authorities have been able to solve high-profile terrorism cases precisely because of the cooperation of hawaladars. It appears informants and other police methods in India can penetrate the generally observed veil of secrecy (personal interviews).

In the U.S., there have been several cases of “material support to terrorism”, most of which are still ongoing and cannot be discussed. An al Qaeda case involving Hawala financing out of a western African country was reportedly uncovered by the FBI. More information is not currently available as the FBI has been unable to share any outlines of the case with the author or FinCEN. On the other hand, during a congressional hearing, a witness stated that an informal

remitter from South America sent funds used for the first World Trade Center bombing. Efforts to confirm this through a number of regulatory, law enforcement and intelligence agencies failed.

On the other hand, the bombing of the U.S. African embassies was at least partially financed through hawala networks in Kuwait, Yemen and Nairobi. The ledgers showing a \$1,000 transaction were kept and produced at the trial, showing once again how baseless is the assertion that hawala is a paperless mode of transacting, a black hole for investigators. Very often, the key question is where can some records or person be found to trace a given transaction. It may be that accountability and constant transparency are not hawala's main characteristics, but traceability is not always a problem.

World Bank research suggests Afghani hawaladars' ability to serve international and non-governmental organizations and make cash payments of hundreds of thousands of U.S. dollars in areas in need of reconstruction may be explained in part by the use of illegal drug, arms and smuggling money (personal interviews).

It is to be expected that, as financial controls are tightened around the world, financiers of militancy will actively explore IVTS as alternative methods. If it is not hawala-type of networks, they may be IVTMs. In addition to interfaces with legal entities and individuals, hawala also come into contact with all kinds of transnational criminal activities as noted above. Ordinary criminal actors also deal with militant groups, as the latter seek not only to transfer money for specific activities, but also raise funds for their overall operations.

The available literature and research conducted for this report suggest the sources of funding for terrorist actions are only limited by one's imagination. What makes particularly challenging the flagging and tracking of terrorist funds is that they may be perfectly clean at the beginning, such as funds from state agencies, charities and businesses (Levitt, 2002; Greenberg et al. 2002; McCoy and Cauchon, 2001). This is a significant difference between this task and that of countering money laundering

Some of the most usual legal sources of terrorist finance are the following:

- |   |  |
|---|--|
| <ul style="list-style-type: none"><li>• Funds diverted from charities</li><li>• Use of commercial entities</li><li>• Door to door solicitations</li><li>• Dues from local institutions</li><li>• Speaking tours</li></ul> | <ul style="list-style-type: none"><li>• Cultural events and fund raisers</li><li>• Investments in stocks, real estate, etc.</li><li>• Contributions from the wealthy</li><li>• Contributions from state agencies</li></ul> |
|---|--|

On the other hand, the criminal sources (easier to act against, since they are proceeds of crime from the start) include the following:

- Drug trafficking
- Taxation of criminal groups operating in their “jurisdiction”
- Kidnapping
- Robbery
- Extortion
- Cigarette smuggling
- Bust-out (credit card) frauds
- Welfare frauds
- Gold, precious stones and other smuggling
- Sale of counterfeit goods
- Unauthorized covert operations of intelligence services

Terrorism funding has gone through all of these channels. Contributions have been made through ordinary crimes that yield profit, from sympathizers or those afraid of being attacked by certain groups (e.g., similarly to protection rackets), from drug trafficking and gun running or from charities that may have been forced, "taxed" or milked unknowingly (Lee, 2002).

The above lists are merely illustrative. One of the issues they point out is the challenge facing terrorism controllers, as two sets of conflicting factors operate internationally. First, there is a tension between the objective of financial institutions in the global North to accumulate as many assets and deposits as possible and the introduction of more financial controls. Combined with the fact that most money - criminal, hot or legal – gravitates toward the strongest currencies, there have been few incentives for genuine due diligence and know your customer practices (Levi, 1991, Naylor, 1987). As a result, massive amounts related to capital flight and tax evasion have been flowing to U.S., European and Japanese institutions. A large part of laundered money also ends up there.

Certain conditions have changed in the post 9-11 context. Counter-terrorism and a plethora of new regulations have made for increased alertness, analysis and reporting of suspicious transactions to authorities. Although such practices are far from perfect in confronting serious crime (Naylor, 1999), much more thought, energy and resources are invested in the effort to prevent terrorist finance and other economic crimes. Whereas the general neo-liberal trend is for deregulation and minimal state interference in markets (Passas, 2000), certain types of financial regulation have moved in the opposite direction (Braithwaite and Drahos, 2000). In any

event, the aim of maximum deposit taking can and does get in the way of effective financial controls.

Secondly, cross-border trade has been growing and relentlessly promoted by governments and regional or international organizations, such as the Organization for Economic Co-operation and Development (OECD) and the IMF. As the volume and value of commodities rise, so does the vulnerability of legitimate trade to abuse by terrorist groups and other criminals. It is plain that the more items are moved from country to country for transit or final use, the easier it is to mis-invoice the shipments in order to hide underlying value transfers. Moreover, traders prefer a minimalist approach on the part of state authorities, especially in the wider context of neo-liberalism<sup>11</sup>. Beyond the financial controls against terrorism, trade poses another difficult task for authorities trying to ensure that no hazardous material or weapons of mass destruction enter their territory through containers. Yet, trade-based fund-raising, value transfers and criminal acts (e.g., customs violations, smuggling, tax evasion, money laundering, etc.) remain comparatively neglected by researchers and policy makers alike<sup>12</sup>.

In short, the promotion, mobility and volume of financial assets, commodities and people are frequently at loggerheads with strict anti-terrorism policies and controls. Finding the best balance of economic activity and security measures is a daunting challenge that is likely to stay with us for quite some time. In this light, scholars and other researchers have the responsibility to provide the most careful, systematic and precise analysis of the social organization of IVTS, terrorist groups and other criminal actors. The nexus of such actors is becoming well established (Greenberg et al. 2002; Gunaratna, 2002; Lee, 2002; Levitt, 2002, 2002b; Morais, 2002). It is solid data and thoughtful study of them that ought to guide authorities in the very difficult work ahead.

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<sup>11</sup> Neo-liberalism refers to a school of thought on how the state relates to its citizens and the world of trade and commerce. It promotes minimal interference in the market and aims at the lifting of barriers to trade and business transactions across regional and national borders.

<sup>12</sup> This is the main subject in the new NIJ-funded project directed by Prof. N. Passas.

## **POLICY IMPLICATIONS**

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National and international actions targeting the funding of militant groups intensified in the aftermath of what are widely believed to be al Qaeda-related actions around the world (USA, Kenya, Indonesia, S. Arabia, Morocco, Turkey and elsewhere). This study focused on the financial aspects of official responses to the actions of these groups.

Terrorist actions and the responses to them are increasingly transnational, as they affect or involve more than one jurisdiction at the same time. The main challenge is separating legitimate activity from abuses and criminal actions. Collateral damage to innocent actors and the undermining of ordinary trade needs to be avoided. In order to strike an appropriate balance between controls and social freedoms, we must have a good understanding of terrorists' modus operandi, better indicators of abuse of financial institutions.

Further, international law enforcement cooperation should be based on such understanding and firm evidence of wrongdoing so that the targeting of actors can be as accurate as possible. Interviewees in many countries repeatedly underlined their unhappiness with U.S. law enforcement practices after 9-11. In some cases, legal principles and procedures were completely ignored in the urgent hunt for evidence and clues.

The problem has been two-fold. Firstly, in certain instances, faulty intelligence or optimistic promises of evidence from the U.S. persuaded overseas counterparts to act fast and aggressively. When the time came for the production of evidence so that the legal processes can move forward, there was precious little coming from the U.S. agencies prompting the action. The foreign agents and their institutions were left exposed to criticism and embarrassment.

Secondly, there have been investigations that failed to produce solid evidence to keep people and entities on national and international lists (see below). The inclusion in such list has had devastating effects on those concerned, but most critically, there is no recourse. Because no charges are filed in any court or commission, designated people have no forum or vehicle through which they can be given a chance to correct errors or defend themselves. It is even more important, therefore, to remove people from such lists, once it is established this naming is no longer warranted. Yet, names have been left languishing on such lists despite widespread recognition in law enforcement and other circles that there is simply nothing to justify such draconian, or indeed, any action.

A consequence of these practices is that a good deal of global good will and sympathy towards the U.S. after 9-11 has been squandered. Future collaborations may therefore be seriously undermined, if no attention is paid to these problems. It is enough that popular sentiment has turned highly critical of some U.S. policies in foreign jurisdictions. It would be tremendously unhelpful for the fight against any radical militants to add controllers and their agencies to the list of critics.

At the same time, it is very widely recognized that preventive and other actions are required to deal with the risks of terrorism. Regardless of how low-cost many terrorist activities may be<sup>13</sup>, there is always a need for training, communications, travel, equipment, false papers, living and other expenses. As a result, financial controls are a major part of the fight against terrorism.

The pursuit of such controls is worthwhile for at least three reasons. The first one relates to efforts to minimize the impact of any actions that are not prevented. According to official sources in the U.S., the first attack against the World Trade Center took place earlier than planned and was less devastating than intended by Ramzi Yusef, the convicted mastermind of the attack, because of the group's limited financial resources<sup>14</sup>. Secondly, tracking financial transactions can be useful in after-the-fact investigations. It was financial information, for example, that helped establish the first links between the 9-11 hijackers and other conspirators (Lormel, 2002). Thirdly, making clear that authorities pursue financial controls against extremist militants and their supporters forces them to be on edge, change their methods, communicate with each other, which creates more opportunities to collect valuable intelligence.

It is clear, nevertheless, that financial controls are no panacea and, if not well focused, may produce negative consequences. The most important task, thus, is devising strategies, policies and measures directed at terrorist financial targets and avoiding unfair, unnecessary and counterproductive side effects on innocent actors engaging in legitimate financial transactions and commerce. As especial emphasis has been placed on certain traditional ethnic methods of

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<sup>13</sup> The entire operation leading up to September 11 is estimated to have cost approximately U.S.\$ 500,000 over a period of about two years; the first attack on the World Trade Center cost only \$18,000

<sup>14</sup> See statement of former FBI Director L. Freeh before the Senate Committee on Appropriations, Subcommittee for the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies, Washington, D.C., Feb. 4, 1999.

fund transfers in South Asia, Africa and the Middle East, such as hawala, this report centered on such transfer channels, their significance, mechanics and policy issues.

The USA Patriot Act (2001) strengthened anti-money laundering statutes and provided law enforcement agencies with quite powerful tools and powers to investigate and try to prevent terrorist activities. This Act also made specific references to IVTS, as the U.S. Congress showed concern about hawala-type of networks and the inability to trace informal transactions. Executive Order 13224 froze domestic assets and blocked all transactions of individuals and organizations supporting terrorist activities.

The most significant international initiatives include the 2000 International Convention for the Suppression of the Financing of Terrorism, the UN Security Council Resolution 1373 (2001) on the financing of terrorism and the Financial Action Task Force (FATF) Eight Special Recommendations on Terrorist Financing (see also UN Security Council Resolution 1390 [2002]).

Approximately US \$121 million was frozen globally by the end of 2002 (Lee, 2002). As the FBI maintains a list of "most wanted terrorists", several additional lists of "terrorist organizations" were created in the United States by the State Department (a "terrorist exclusion list" and "foreign terrorist organizations"), the Treasury Department (which included "specially designated global terrorists" in the "specially designated nationals and blocked persons"), in addition to those kept by the United Nations, the European Union and other countries and organizations. Those lists are not uniform, as they are not based on the same definitions or criteria for terrorism (CDI Terrorism Project, 2002; Lee, 2002). Many of what were considered al-Qaeda and bin Laden assets have been seized and frozen.

Nevertheless, al Qaeda networks seem to be able to raise and transfer funds for the operations of their cells around the world, partly by relying on informal networks and the trade or smuggling of commodities (UN Monitoring Group, 2002, 2003; personal interviews) and partly through ordinary business and charities (Levitt, 2002; McCoy and Cauchon, 2001).

There are three main difficulties with respect to financial controls. Firstly, the reliance on informal methods is deemed to be increasing (Lee, 2002: 3). These methods remain largely unregulated or de facto beyond regulation (see below). Secondly, the frequent interface between legal and criminal/terrorist actors makes it harder to build a predictive model that can assist law enforcement in its efforts to anticipate terrorists' moves and attacks. In order to accomplish that,

a great deal more background information and solid evidence on the social organization of al Qaeda and related groups are necessary. Third, unfocused or careless financial controls may backfire.

Some of the risks entailed by policies not thoughtfully conceived could be:

- Reduction of the positive economic impact of labor remittances at the local, regional and national level;
- Criminalization of otherwise legitimate actors;
- Higher human costs (e.g., families of immigrants not receiving desperately needed income);
- Alienation of large segments of population from the government or those perceived as driving the national and international regulatory efforts; and,
- Shift from IFTS to IVTMs, such as mis-invoicing or trade diversion.

The point is that authorities are currently attempting to regulate and render more transparent IFTS (under whatever terms they use; e.g. money service business or MSB). To the extent these efforts are not well thought out and accepted by the participants, the intended shift from informal to formal institutions may not occur. Rather a shift towards the use of IVTMs may result.

A further risk is that policymakers know even less about IVTM vulnerabilities and serious criminal abuse. So, policymakers run the risk of not just leaving the door open for more sophisticated value transfer methods that come with a higher capacity for voluminous amounts, but policymakers may be providing incentives for operators and legitimate users to turn to such shady financiers. In other words, insensitive or unsuccessful regulatory frameworks can result in a criminalizing effect for people and funds that are absolutely legitimate. Critically, instead of increasing transparency of fund transfers and reducing crime, policymakers may in fact be encouraging the opposite result.

Moreover, from a prevention point of view, reducing the number of IFTS operations may mean far fewer opportunities to monitor suspicious activities and gather valuable intelligence about planned crimes. To the extent the reported nexus of hawala with terrorist funding is accurate, finding the right balance between the goal of intelligence gathering and shutting down hawala operations is no easy task.

The task of introducing effective regulation, therefore, is more complicated than one might think. In order to achieve the desired goals and avoid unintended consequences, regulation must be the end-result of a long process involving fact-finding, understanding of local cultures and specificities, and consensus building. Some measures recently introduced and considered as positive in many jurisdictions are the following.

### **LICENSING/REGISTRATION**

The debate focuses on whether to require ‘registration’ or ‘licensing’. Some of the literature requires both of them and advocates: “All jurisdictions should introduce a system of registration and licensing of alternative remittance providers, including agents of principal providers” (FATF, 2003).

The definition adopted for regulatory purposes has a huge impact on the decision to license or register. In June 2003, the FATF issued an International Best Practices Paper<sup>15</sup> for combating the abuse of alternative remittance systems (FATF, 2003). In that paper, the FATF rightly adopted a broad definition to transfer systems by using for the first time the term money or value transfer service (MVT service)<sup>16</sup>.

In an attempt to be inclusive, the paper noted that a MVT service may be provided by “persons (natural or legal) formally through the regulated financial system or informally through entities that operate outside the regulated system”; that in some jurisdictions, “informal systems are frequently referred to as alternative remittance services or underground (or parallel) banking systems”; and that often these systems are linked to particular geographic regions and are therefore described using a variety of specific terms such as hawala, hundi, padala, fei-chien, and the black market peso exchange.

As policymakers search for a set of global standards, perhaps it is better to argue for a system which, at a minimum, requires registration and encourages licensing in order to fully comply with the other recommendations being proposed in the implementation package.

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<sup>15</sup> It may be downloaded from the following link: [http://www1.oecd.org/fatf/pdf/SR6-BPP\\_en.pdf](http://www1.oecd.org/fatf/pdf/SR6-BPP_en.pdf)

<sup>16</sup> MVT is defined as “a financial service that accepts cash, checks, 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 MVT service belongs. Transactions performed by such services can involve one or more intermediaries and a third party final payment.”

There are notable differences in licensing/registration criteria in various jurisdictions. In some, it entails a nominal or no cost to licensees, while in others it comes with the requirement to pay a substantial bond or fee. In the US, there is a registration requirement at the federal level and a licensing rule in most States. The diversity of regulatory regimes at the State level is extraordinary and completely uncoordinated ranging from no regulation to hefty bonds and capitalization requirement up to several hundred thousand US dollars or even a million. For many IFTS traditional and small-size or family-run IFTS operators, this constitutes an unbearable burden. It may be preferable to either remove the cost of licensing (is the main objective to raise revenue or to implement effective regulation?) or reduce it and scale it to the volume of IFTS business to be licensed.

### **REPORTING REQUIREMENTS**

There has also been a tendency for regulators to call for the introduction of transaction reporting duties “in line with their current reporting requirements for financial institutions” (FATF, 2003: 8). This approach comes dangerously close to attempting to turn hawala and other IFTS into formal institutions. International efforts to maintain consistency with formal financial sector requirements need to bear in mind that we are dealing with a different financial creature. Is it possible to design reporting requirements tailored to their operating characteristics?

The US approach has been to require the registration of IFTS at the federal level (with FinCEN) and licenses at the state level. Failure to get a state license, as required, constitutes a federal felony with heavy sanctions provided. Under current laws, IFTS also must employ customer identification procedures for certain transactions, maintain financial records for some time, and are required to file Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs).

The US Department of the Treasury deems the Bank Secrecy Act and the Patriot Act provisions sufficient for the regulatory tasks relative to all IVTS for the time being. A report emphasized the need to continue monitoring the situation in order to see whether adjustments are necessary with respect to IVTS. FinCEN and Treasury recognized also the need for a more complete understanding of all types and mechanisms of IVTS by controllers and lawmakers (Secretary of the US Department of the Treasury, 2002). However, there has not yet been a systematic assessment of the compliance rate to the new regulations. Some cases brought to light

by law enforcement actions indicate the continuing operation of unlicensed informal remitters. Given the record-keeping practices of IFTS operators and their own “customer identification” practices, it is to be expected that at least some ethnic IFTS operators probably have not registered. In addition, ledgers or notes maintained by such operators in code or shorthand that make it impossible to decipher, gaps in kept records or the service to customers with no questions about their true identity, the origin of their money, or the reason for the transfer would often constitute violations of US regulations.

Similarly to most countries with formal rules about IFTS and despite calls for outreach and attempts to do so with various communities, efforts have been primarily in the direction of communicating to remitters their duties and obligations - that is after the rules were put in place.

This is precisely why a consultation process is necessary; trust is the core element of IFTS operations. How and under what circumstances can they be expected to violate this element and provide information on their clients to the authorities? Attempting to guess the answer or simply applying standards tailored for formal institutions to IFTS does not seem to be the most appropriate way of constructing and implementing effective policy measures.

#### **TOWARDS AN INTERNATIONAL REGULATORY FRAMEWORK**

While the literature-to-date discusses the context or the conditions under which their respective recommendations can or ought to be implemented in various sections of their text, there has been insufficient discussion on the pre-conditions to effective regulations.

In its examination of recent and on-going regulatory practices, an IMF-World Bank study noted that for purposes of achieving long-term financial sector development and minimizing the potential risks of financial abuse and criminal activity, a two-pronged approach is required (el Qorchi et al., 2003). In countries where an informal hawala system exists alongside a well-functioning conventional banking sector, it is recommended that hawala dealers be registered and keep adequate records in line with the FATF recommendations. Efforts should be made to improve the level of transparency in these systems by bringing them closer to the formal financial sector without altering their specific nature. In conflict-afflicted countries without a functioning banking system, requirements beyond basic registration may not be feasible because of inadequate supervisory capacity.

Simultaneously, the regulatory response should address weaknesses existent in the formal sector. The formal and informal financial systems tend to benefit from each other's deficiencies. Policy-makers should address economic and structural weaknesses encouraging transactions outside the formal financial systems, as well as the weaknesses in the formal financial sector itself.

The IMF/World Bank report emphasized that prescribing regulations alone will not ensure compliance. Regulators need to possess the appropriate supervisory capacity to enforce the regulations, and there need to provide incentives towards compliance with the regulations. Compliance is likely to be weaker where there are major restrictions on transactions through the formal financial system; it cautioned the application of international standards needs to pay due regard to specific domestic circumstances and legal systems; and concluded policy-makers should acknowledge the existence of practical reasons, from the customer's point of view, to resort to these methods rather than formal banks for international payment purposes. As long as such drivers exist, the hawala and other IFT systems will continue to exist, and thus addressing IFT will require a broader response, including well-conceived economic policies and financial reforms, a well developed and efficient payment system, and effective regulatory and supervisory frameworks.

International efforts toward the harmonization of standards must take into consideration the specific domestic circumstances, cultural traditions, and legal systems. It cannot be over-emphasized that IFTS is not the only or most important financial vehicle used by terrorists nor the most vulnerable to abuse for other crimes. In countries where informal systems exist alongside a well functioning conventional banking sector, it is recommended that hawala dealers be registered and keep adequate records in line with FATF recommendations. Efforts should be made to improve the level of transparency in these systems by bringing them closer to the formal financial sector without altering their specific nature. Even there, however, there can be instances of genuine difficulties in applying the FATF recommendations without major adjustment (see, for example, the experience in South Africa where identification is problematic without a tribal leader; personal interview). In conflict- and poverty-afflicted countries with no functioning banking system requirements beyond basic registration may not be feasible because of lack of supervisory capacity.

Acknowledging the legitimate and indispensable functions performed by IFTS is again stressed. This point has wider public and other policy implications, because hawala and other IFTS serve millions of legitimate and mostly poor recipients of remittances in the global South. Consequently, it is vital that authorities

- explore ways of offering additional channels for fund transfers
- assist financial institutions
- ensure continuation of vital services and minimum social or economic disruption
- improve institutional or official methods offering similar services; and
- reduce economic and other asymmetries, which are the root causes for IFTS and global crime (see Passas, 2000)<sup>17</sup>.

After such policies are implemented, cracking down on criminal IFTS uses will become an easier task as there will be fewer or no legitimate clients to worry about.

Furthermore, experience suggests that regulation is most effective when those subject to it participate in its formulation and/or regard it as appropriate and legitimate. Efforts should also, then, be made to engage IFTS operators and their clients in a consultation process conducive to a consensus on what measures and steps are desirable and necessary. Before the awareness-raising campaigns, it is essential to seek a two-way dialogue, as is the practice quite frequently with ordinary businesses and sectors.

When a consensus-building consultation is complete and before establishing a regulatory framework, it is essential that each jurisdiction undertake a comprehensive awareness raising campaign. If a jurisdiction adopts the FATF special recommendations, the target institutions must be involved in a dialogue that accommodates their interests, concerns, and specific institutional characteristics.

Further, as Maimbo and Passas have pointed out, it is important to emphasize that for these campaigns to work, it is essential to recognize the following:

- Their focus should be on identifying and, if necessary creating positive incentives for the operators to become active participants in the implementation of a regulatory and supervisory framework.

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<sup>17</sup> This point requires further elaboration. It is currently underway and will become a chapter in the report for the continuation grant and an independent paper.

- In some cases, the operators are highly trained and well educated individuals. Some are former bankers and well aware of the concerns shared by regulatory and law enforcement agencies.
- Although operators are often geographically dispersed and engaged in a variety of businesses, they tend to be aware of their competitors' identities. In some cases, like Afghanistan, they might have an informal association or recognized leadership. Generally this may be someone who has been in the business in the area, the longest or they may provide wholesale settlement services. Awareness campaigns are best advised to seek out such informal bodies and to work with them in each community or area.
- Although terrorist financing concerns are of greatest importance given the obvious consequences that they present, awareness campaigns ought not to focus on this risk *exclusively*. Doing so, risks creating a level of unease or discomfort that may discourage operators from working with regulators (Maimbo and Passas, 2004).

## CONCLUSION

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A growing body of work is now finding that the terrorist financing, like other criminal activities, involves a mix of formal and informal methods and networks. Given the use of IVTS by legitimate and criminal actors, fully understanding its workings will require better comprehension of transnational crimes and legal financial systems. Also, studying IVTS more in depth can contribute to a better understanding of transnational crimes.

Despite a recent surge in interest and research activity, the social organization of transnational crime remains relatively under-studied (National Research Council, 1999). There are on-going debates as to the basic facts. For instance, some observers draw sharp distinctions between political offenders and other criminal categories and conventional actors (Dishman, 2001; Hoffman, 1998). On the other hand, there are plenty of examples where such lines are quite fuzzy. Terrorist groups have also shown that they can mutate from political to profit-driven organizations (Lee, 2000; Stern, 2003).

Terrorism-related evidence has been accumulating in many countries from civil and criminal proceedings as well as other actions. It is urgent that these pieces of the puzzle are collected and analyzed, in order to convert this knowledge into effective policies and indicators of abuse.

Trade-facilitated transfers are extremely sensitive because they allow for the secret circulation of very high amounts of money, but need to be monitored without hampering legitimate international trade. For this reason, an in-depth study of these methods is necessary. This would be conducive to better training of officials seeking to detect and separate legal practices from suspicious and criminal abuses.

It may be useful to separate funding sources from transfer sources. The two may often coincide, but it is helpful to separate them at least analytically. Financial controls of terrorism are hampered by the fact that funds may be legal at the beginning. However, the transfer method can be suspicious or illegal per se. Establishing that fact can be potentially helpful in stopping clean funds from reaching criminal recipients. At the same time, we need to be careful about the targeting of particular groups or individuals and mindful of the possible consequences on national and international interests. As has been noted, some analysts draw attention to the "significant domestic and international costs, e.g., infringing on civil liberties or religious

freedom, alienating large Muslim constituencies, inflicting harm on poor countries, and aggravating conflicts with Islamic states" (Lee, 2002: 1).

Several individuals and organizations subject to law enforcement action in the aftermath of 9-11 were released or removed from terrorism lists for lack of evidence. This is particularly problematic not only because of human rights and due process issues, but also because the "collateral damage" produced by such actions includes the draining of political capital (to be used for international cooperation) and the rise of anti-Western sentiments in communities and regions, which are needed in a coalition against terrorism. To the extent that the targeting of financial activities or funds is inaccurate, such collateral damage is needless, unfair and expensive.

For these reasons, improved indicators of abuse and some predictive model on terrorists' objectives and modus operandi would go a long way to support the work of law enforcement and policy makers. In order to do this, a better understanding of the networks of terrorist finance, including the wider nexus with other criminal groups and legitimate organizations, is required.

Extremely helpful would also be the establishment of a method enabling the connection or association of financial and trade transactions. It is possible and common in both cash-intensive and other societies to withdraw funds in cash and use them for the purchase of goods to be transferred or other transactions. Goods may then be shipped elsewhere and the proceeds of the sale transferred to another location. By shifting from financial to commercial transactions, the trail of the whole set of transactions is lost to investigators. At this point, no country has the means to make this connection. This is a point of vulnerability to which controllers should pay closer attention.

Hawala and similar IVTS are by no means the only soft spot in international finance. The settlement process among hawala operators and the trade-finance connection is a more significant problem, which remains not well understood and highly vulnerable to serious abuse. The amounts of money involved in commodities trade can assist not only small cells of terrorists but also significant weapons proliferators. The problem seems to be particularly acute with respect to the trade in gold, precious stones, tobacco and alcohol (Farah, 2002; Kaplan, 1999; UN Monitoring Group, 2002).

Therefore, focusing on one type of IVTS or ethnic group is not only perceived as discriminatory (which undercuts efforts to build an alliance against al Qaeda or other terrorist

groups), but also misses the point and opens up opportunities for criminals to take advantage of inattention to certain routes or networks for easier and undetected value transfers.

Traditional IVTS, such as hawala, are part of the culture of many ethnic groups and serve legitimate needs. Any attempts to regulate them without understanding their inner workings cannot be expected to work. Authorities ought to seek the input of operators, users and intermediaries. Else, the element of trust that is one of their defining elements will be violated. Consequently, IVTS may be driven more underground, may become more secretive and better organized. Such attempts at insensitive regulation may also generate ill will and discontent with the West.

Western models of regulation are neither a guarantee of success nor appropriate for all types of relationships and contexts. So, outreach and consultation programs, which may provide insights into novel modes of regulation are strongly recommended. This should also enhance compliance and collaboration of IVTS operators and users.

Policy makers should also focus on the exploration of new institutional and other ways of offering legitimate users of IVTS additional and inexpensive channels for fund transfers, in order to avoid disruption in the provision of vital services in certain regions and countries.

For their part, governments ought to ensure international cooperation of law enforcement and other authorities is genuine and of higher quality. Seminars, joint training, awareness-raising for both domestic and foreign organizations are part of the solution. Cooperation will be further enhanced when law enforcement requests for assistance are based on facts rather than suspicions and uncorroborated evidence.

Finally and most importantly, scholars and policy makers should spend their energies in devising long-term strategies. Anti-US and anti-Western feelings make the recruitment of suicide bombers much easier. That takes little funding and financial controls cannot do much about them. Therefore, we must understand and fight the roots of terrorism-producing conflicts and other serious crime problems. Terrorism and geopolitics need to be connected in our analyses, as they are in reality. Supply-side approaches can only have a limited short-term effect. Demand-side policies hold the best promise for a safer planet and protection of US interests. Criminal justice approaches constitute only an immediate term response, but can offer no hope of addressing the problems in the long run.

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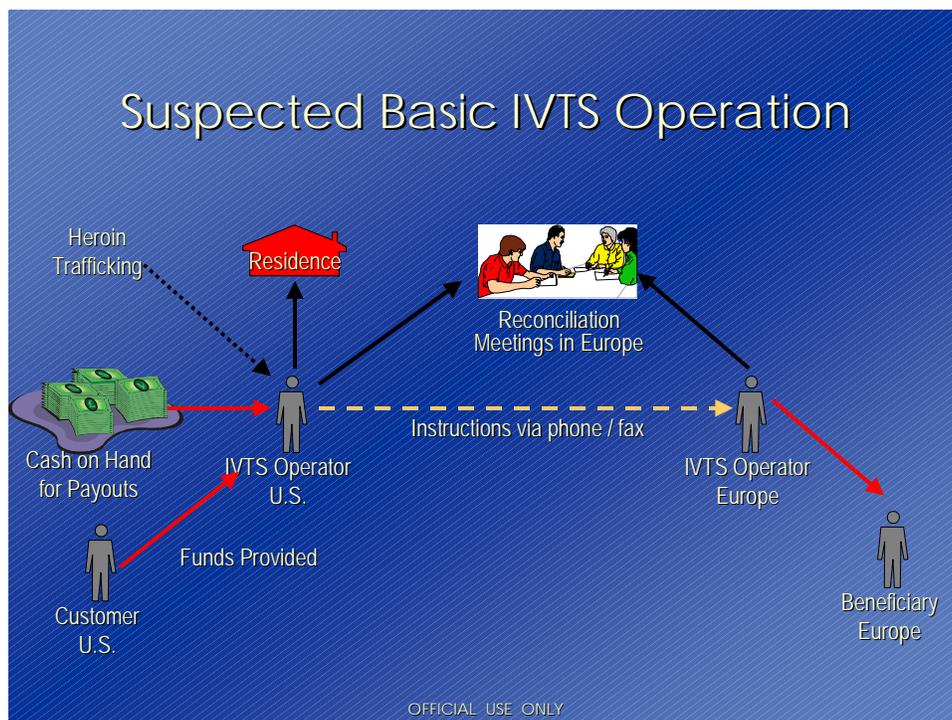
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## Appendix: Case Summaries

### Case 1

#### Suspected Basic IVTS Operation

- ❑ A recent law enforcement investigation identified a non-licensed/registered IVTS operator who provided transfer services to countries in Europe and abroad.
- ❑ The U.S. IVTS operator is a suspected narcotic trafficker.
- ❑ The operator also provided transfer services for customers wishing to send money FROM an OFAC blocked country located in the Arabian Gulf.
- ❑ The IVTS operator provided his services from his residence.
- ❑ In order to execute payments the operator utilized other IVTS operators in countries abroad in which instructions were provided via fax and phone.
- ❑ Payments were made using a basic hawala system<sup>18</sup>.
- ❑ The operator maintained over \$1,000,000 of cash at his residence (believed to be maintained for cash pay-outs).
- ❑ IVTS balances were reconciled through the U.S. IVTS operator meeting with other IVTS operators in Europe.

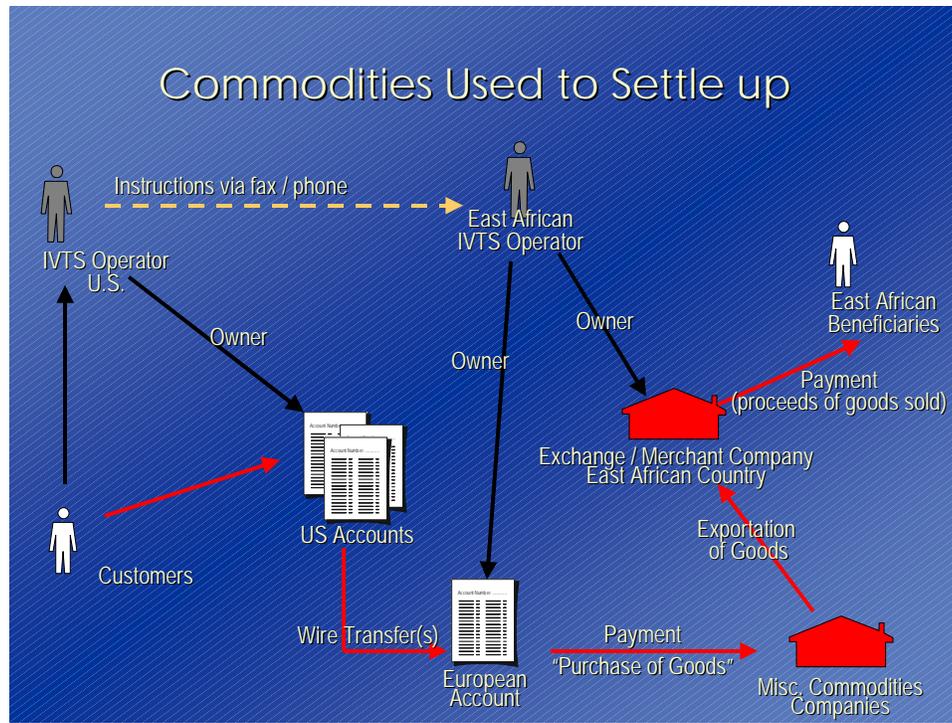


<sup>18</sup> Information is subject to change as the case fully develops.

Case 2

**Use of Commodities to Reconcile Transfer Payments Between IVTS Operators**

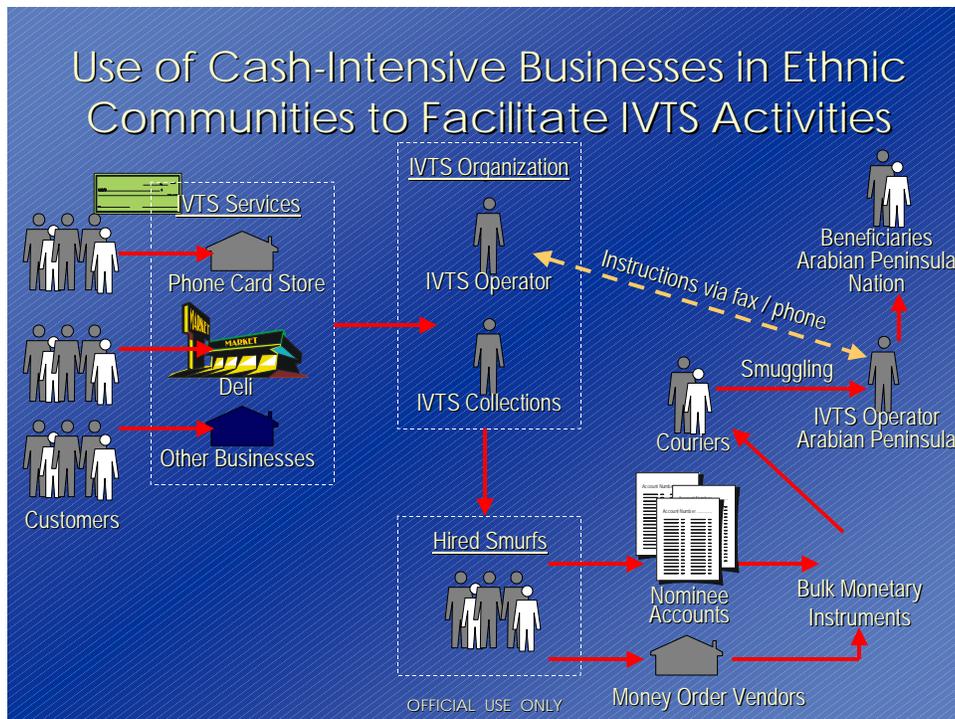
- ❑ Law enforcement has identified an IVTS operator who provided remittance services to nationals of an East African nation residing in the U.S.
- ❑ People wishing to send money would contact the U.S. IVTS operator and arrange to send money to the operator through one of two methods: 1) the person wishing to send money physically provides the funds to the IVTS operator; 2) or the customer deposits the funds to be transferred directly into the operator's account.
- ❑ The sender provides the name and phone number of the beneficiary to the operator. The sender also faxes a copy of the deposit receipt to the operator indicating a deposit was made into the operator's account-if that method was used.
- ❑ The operator then faxes the payment instructions to his counterpart (family member) located in the East African country. The beneficiary picks up the money from the sender at an exchange business operated by the East African IVTS operator. Funds (proceeds of commodity sales) paid to beneficiaries are withdrawn from a reserve account maintained by the exchange.
- ❑ Funds collected by the U.S. IVTS operator were not automatically sent out of the U.S. Usually the U.S. operator would allow the balance of his operating account to accumulate to \$10,000.00 before making a wire transfer.
- ❑ The money is eventually wire transferred to an account located in a European country that is controlled by the East African IVTS operator.
- ❑ The European account is used by the East African operator to purchase goods in bulk that are imported back to the East African national, and further sold at the same location as the exchange.
- ❑ Proceeds from the sale of those products are maintained in a reserve account that functions as the primary source for paying money out to beneficiaries from the company's IVTS activities.



## Case 3

### Use of Cash Intensive Businesses In Ethnic Communities to Facilitate IVTS Activities, Case A

- ❑ Law enforcement efforts identified a case in which an organization provided unlicensed remittance services for nationals of an Arabian Peninsula country residing in the U.S. Numerous businesses within the ethnic community collected money from individuals wishing to send funds back home. A small fee was charged for the transfer services. The funds were then converted to monetary instruments to be smuggled out of the country.
- ❑ An agent of the organization would then collect the funds from area delis, travel agencies, and other miscellaneous stores, that served as the primary points of contact for people wishing to remit funds.
- ❑ The U.S. IVTS operator would then phone and fax all of the transaction orders to another IVTS operator located in the Arabian Peninsula. The beneficiaries would be paid prior to the actual transfer of funds.
- ❑ Once cash was collected from the collecting agent of the U.S. organization, several individuals were then enlisted to convert bulk cash to money orders and other types of negotiable instruments. Cash was also structured into nominee bank accounts maintained by area banks. Numerous financial institutions captured some of the structuring activity and subsequently filed SARs.
- ❑ Once the cash was converted or deposited into accounts, checks and money orders from the conversion of the funds were provided to couriers who physically smuggled the instruments to the Arabian Peninsula nation.
- ❑ Once the Arabian Peninsula IVTS operator received the instruments, he negotiated them through a local bank's correspondent account maintained by a U.S. bank.



## Case 4

**Use of Cash Intensive Businesses In Ethnic Communities to Facilitate IVTS Activities, Case B**

- ❑ Law enforcement investigations identified an organization involved in a multitude of criminal activity to include ephedrine trafficking, cocaine/heroin/methamphetamine trafficking, food stamp fraud, resale of stolen property, etc. The organization utilizes numerous businesses and individuals within the ethnic community to facilitate its illegal activities<sup>19</sup>.
- ❑ The organization also runs a money remitter business that caters to nationals of an Arabian Peninsula country residing in the U.S. The business is unlicensed in the state where it is located and not registered with the federal government.
- ❑ People wishing to send money through the business contact an agent of the company in which the customer pays the remitter for the service in addition to providing beneficiary information. The U.S. IVTS operator coordinates the payment with his counterpart located in the Arabian Peninsula nation via phone and fax.
- ❑ Beneficiaries pick up money from the broker located in the Arabian Peninsula nation.
- ❑ The actual movement of funds is conducted later when bulk cash is deposited by agents of the organization into personal and business accounts. SARs filed by financial institutions

<sup>19</sup> Based in part on cultural and socio-economic grounds, members of certain ethnic groups mutually support one another in numerous aspects to include financial support in the establishment of businesses. Criminal elements within these ethnic groups also play an active role in supporting the establishment of new businesses through financial support. Thus, the business that is opened with the assistance of funds from criminal organizations becomes vulnerable to facilitating future criminal activity. This can take place as people trusting each other will not always ask about the origin or destination of funds. A blind eye or genuine ignorance can effectively provide cover for activities such as the reselling of stolen goods or the active participation in other illegal activities such as food stamp fraud, coupon fraud, and money laundering.

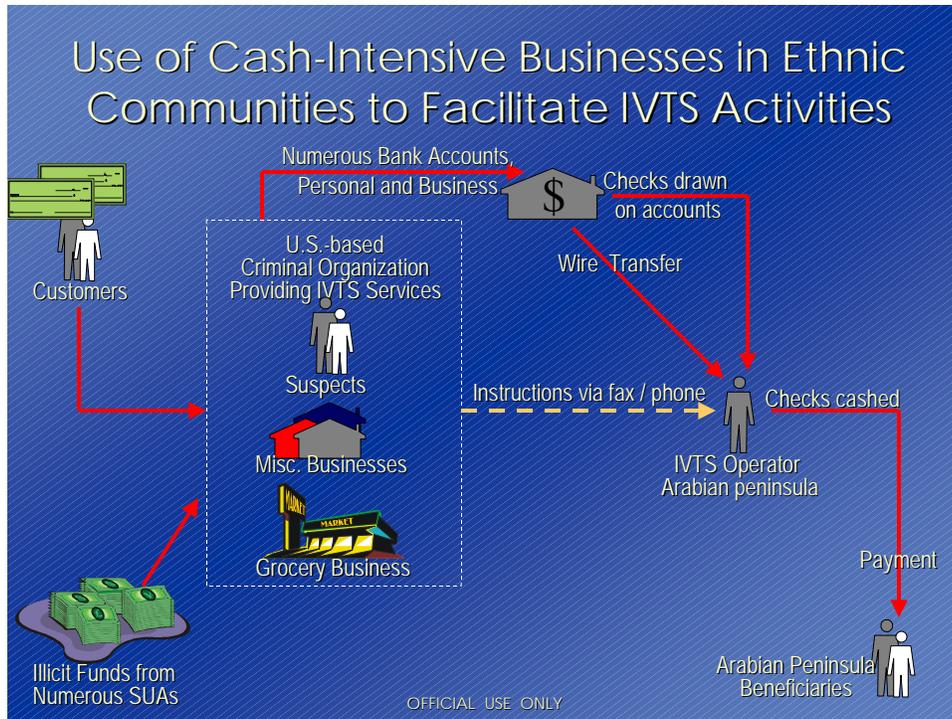
indicate many of those transactions were structured. Money orders and third party checks<sup>20</sup> are also used to deposit funds into accounts or to purchase cashiers checks from financial institutions.

- ❑ Funds deposited into accounts owned by the criminal organization in the U.S. were reconciled with the Arabian Peninsula IVTS operator through the use of checks<sup>21</sup>.
- ❑ Checks were mailed (via commercial mail) to the IVTS operator located in the Arabian Peninsula nation where they were negotiated through local financial institutions that had correspondent bank accounts with U.S. financial institutions.

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<sup>20</sup> Law enforcement agents have determined the organization often uses third party checks drawn on other business accounts. The technique includes the purchase of the third party checks by the criminal organization that are used to purchase cashiers checks from area banks. The use of this technique further complicates the audit trail in identifying the original source of the funds.

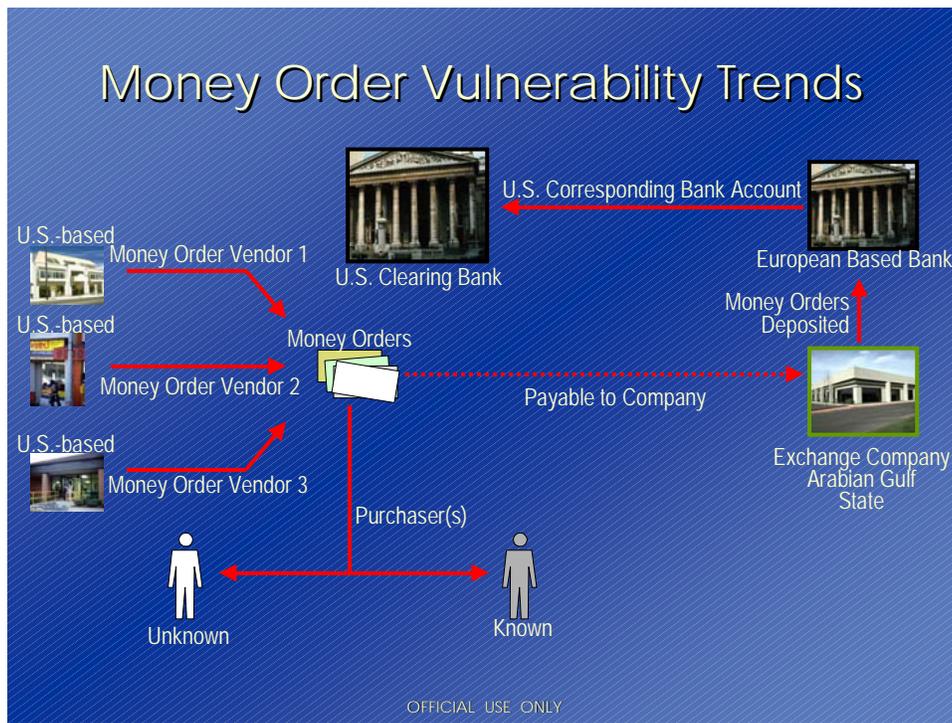
<sup>21</sup> The use of checks drawn on respective accounts was the most prominent method used to send money to an African Peninsula Country. It is believed wire transfers were also used as an adaptation resulting from check seizures made by law enforcement during the course of the investigation. Cashiers checks were also used as part of the scheme to reconcile accounts between the criminal organization located in the U.S. and the IVTS operator located in the African Peninsula Country.



Case 5

**Use of Money Orders to Facilitate IVTS Activities**

- ❑ An IVTS operator located in the U.S. facilitated the transfer of illicit proceeds generated by alien smuggling activities on behalf of criminal elements located in the U.S. and South Asia.
- ❑ Both known and unknown subjects converted these criminally derived funds by purchasing money orders at multiple U.S.-based money order vendors. Money orders were purchased at each vendor in such a manner to circumvent federal reporting and recording requirements.
- ❑ Money orders were then consolidated and forwarded<sup>22</sup> to an exchange/precious metals company located in an Arabian Gulf country, where they were negotiated through a European based bank with a possible branch located in the Arabian Gulf country.
- ❑ The money orders were then cleared through a U.S. corresponding bank account maintained by a major U.S. bank on behalf of the European bank.

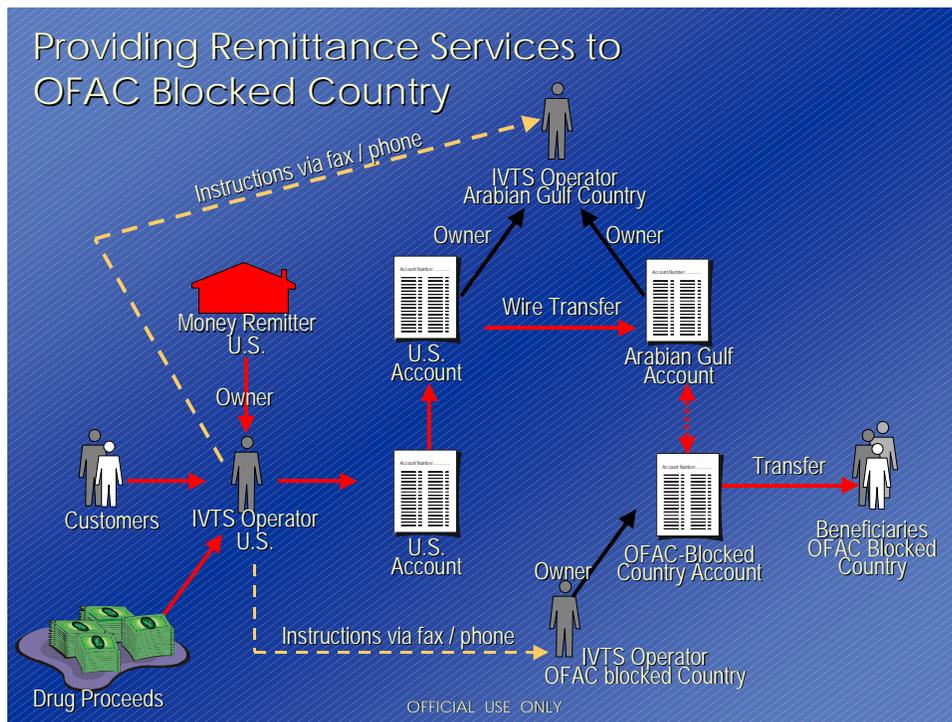


<sup>22</sup> It is believed money orders were sent to the Arabian Gulf country via commercial letter carrier.

Case 6

Providing Remittance Services to an OFAC Blocked Country

- ❑ A U.S. based IVTS organization advertised its services through several different cultural newspapers and the World Wide Web. Those advertisements indicated the company could send money to an OFAC blocked country located in the vicinity of the Arabian Gulf.
- ❑ In order to send money through the company the customer would make contact with the IVTS operator, and would provide their name and the name and account number of the beneficiary located in the OFAC blocked country.
- ❑ There was no commission for the transaction but profit was realized through the exchange rate. The IVTS operator also provided services to known drug traffickers in which a 5% flat fee was charged for moving money derived from criminal activity. The operator was fully aware the money being transferred originated from drug trafficking.
- ❑ The operator would then fax instructions to an IVTS operator in the OFAC blocked country in addition to another IVTS operator located in another Arabian Gulf country.
- ❑ The IVTS operator located in the OFAC blocked country would provide funds to the beneficiary upon confirmation of the instructions sent by the U.S. IVTS operator.
- ❑ Once the U.S. IVTS operator received funds from customers in the U.S. in the form of cash, money orders, and third party checks, the operator would deposit the funds into his account and periodically wire transfer funds to a U.S. based account owned by the IVTS operator operating in the Arabian Gulf country.
- ❑ The Arabian Gulf IVTS operator would then wire transfer the funds from his U.S. account to another account located in an Arabian Gulf country.
- ❑ The money in that account was reconciled with another account located in the OFAC blocked country.



Case 7

**Use of Cash Intensive Businesses In Ethnic Communities to Facilitate IVTS Activities**

- Another law enforcement investigation identified the use of kiosks located in shopping malls and other businesses such as convenience stores to place and layer criminally derived proceeds. The kiosks were also used by criminal elements as money exchanges. Investigators are focusing on human smuggling as the underlying unlawful activity.

Case 8

Remittance of Bulk Cash Proceeds Derived From Heroin Trafficking

- ❑ Law enforcement agencies of a European country identified a number of storefront companies being used by heroin suspects to launder illicit funds.
- ❑ The companies (servicing hawalas) used the services of an exchange company located in an Arabian Gulf country as the means to send proceeds from Europe to other criminal elements located in a Southwest Asian country.
- ❑ Bulk cash was collected from drug sales at three storefront operations.
- ❑ Cash was then deposited into business accounts and remitted to the exchange's account maintained by a U.S. owned bank.
- ❑ Funds were then remitted through the exchange to numerous beneficiaries located in other Southwest Asian countries.
- ❑ U.S. financial institutions filed numerous SARs on the exchange company and on subjects and businesses in the U.S. who received or remitted funds from or to the exchange company.<sup>23</sup>

Case 9

**East African Money Remitters Located in the United States:**

- ❑ Law enforcement identified a business located in the U.S., which caters to remitting funds on behalf of East African nationals.
- ❑ The business is an unlicensed money transmitter and is not registered with the federal government.
- ❑ Individuals operating branches of the business charged a fee of 4%, (1% retained by the broker conducting the transaction and 3% to benefit the East African Money transfer business)<sup>24</sup>.
- ❑ SARs indicate continuous structuring of deposits (mostly cash, but sometimes checks and money orders), through the use of multiple individuals into multiple businesses (relief organization; remittance, exchange businesses), or personal accounts at multiple banks and branches located in multiple states.
- ❑ Suspects made blatant attempts to circumvent CTR reporting requirements.
- ❑ Accounts of suspects with low-income occupations exhibited unusual flows, volumes of funds, such as student, truck driver, candy store worker, self-employed, unemployed, hotel employee, restaurant worker;
- ❑ Same addresses sometimes being used by multiple suspects.
- ❑ Wire transfers were initiated shortly after deposits were completed funds were then transferred to accounts maintained at banks located in an Arabian Gulf state.
- ❑ Limited knowledge/traceability on the final disbursement of funds once credited to Arabian Gulf banks (black hole syndrome).

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<sup>23</sup> Several cases have been initiated by U.S. law enforcement on a number of U.S. based subjects believed to have done business with the exchange company.

<sup>24</sup> Applies to information from one of the investigations.



Case 10

**Providing Remittance Services to an OFAC Blocked Country**

- ❑ A law enforcement investigation identified six unlicensed money remitters.
- ❑ Investigative efforts identified several of the remitters as possibly remitting funds on behalf of known criminal elements.
- ❑ Investigations are pending to determine if any of the companies violated federal law by remitting funds to OFAC blocked countries<sup>25</sup>.
- ❑ Extensive ledgers were maintained by the entities detailing wire transfer activity.
- ❑ The companies guaranteed money transmission to the OFAC blocked country within 1-4 days.
- ❑ The only beneficiary information required to complete a transaction from the companies was the name and bank account number of the recipient overseas. Select businesses also provided hand delivery of funds to beneficiaries for an additional charge.

Case 11

**Fund Raising Organizations and Possible Links to Terrorist Activities**

- ❑ Law enforcement investigations identified possible links between the owners of a U.S. based relief organization and a known terrorist organization.
- ❑ A central account was used by agents of the company to deposit cash. Several SARs were filed by financial institutions on the suspect nature of the transactions.
- ❑ International wire transactions were then initiated from the account in which funds were sent to Russia, and two former Soviet Republic States.
- ❑ Wire transfers were also credited to the U.S. company account from unknown transactors through a European Bank.
- ❑ The U.S. company also wire-transferred funds to another U.S. based business engaged in similar business activities (charity). All of these transactions are suspect based on the volume of activity affecting the company's account vis-a vis the types of services the company was providing.
- ❑ Wire transfers from the company were credited to a similar type of U.S. based company. That company also is suspected of having an association with a known terrorist organization.

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<sup>25</sup> A full financial analysis of the bank records associated with the case is still pending. However, many of the advertisements posted by the suspect companies indicated they provided transfer services from the U.S. to an OFAC blocked country located in the Arabian Gulf.

Case 12

**IVTS Activities Conducted on Behalf of Known Criminal Elements**

- ❑ Law enforcement identified an extensive IVTS network that provided remittance services and laundered drug proceeds on behalf of a Middle Eastern drug trafficking organization.
- ❑ U.S. financial institutions identified both deposit and transfer activity conducted by agents of the IVTS organization and subsequently filed SARs on the activity.
- ❑ The network sent money through out the world through the use of wire transfer payments.

Case 13

**Use of Money Orders to Facilitate IVTS Activities**

- ❑ Law Enforcement officials initiated an investigation based on SAR referrals that identified the negotiation of bulk money orders through a bank located in a Middle Eastern country.
- ❑ The money orders appeared to have been purchased at various money order vendors located in the U.S.
- ❑ Money orders were then negotiated through a bank located in a Middle Eastern country and ultimately cleared through a U.S. correspondent account.
- ❑ It is unknown how the money orders were transported to the Middle East but it assumed that they were smuggled based on the large volume negotiated.
- ❑ There are indications of ethnic crossovers in facilitating money transfers.

Case 14

**Use of Money Orders to Facilitate Black Market Peso Exchange (BMPE)**

- ❑ Law enforcement identified a BMPE case in which money orders were heavily used to convert drug proceeds to negotiable instruments.
- ❑ The organization in the U.S. worked under the direction of a money broker located in a Central American country. It is believed the money broker would provide instructions to his agents in the U.S. regarding the pick-up of bulk cash derived from narcotics trafficking.
- ❑ Once the cash was picked up, subjects within the organization would immediately convert the cash to money orders. The money orders were purchased from area vendors in a manner to circumvent federal reporting and recording requirements.
- ❑ Agents of the company also structured cash into bank accounts.
- ❑ Once drug proceeds were converted, the Central American broker provided his U.S. agents with coded instructions on the distribution of the funds. Much of the funds were distributed via commercial mail carriers to various U.S. companies on behalf of customers doing business with the Central American broker<sup>26</sup>.
- ❑ Some of the funds were also mailed via commercial carrier or smuggled via courier to the Central American broker where they were further negotiated by third parties.

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<sup>26</sup> The purchase of U.S. dollars by Central American businessmen who wished to get a better exchange rate of pesos to dollars.

## Case 15

### Use of Black Market Brokers, Bank Accounts and Shell Companies

- ❑ A recent law enforcement investigation identified a bank official working in the private banking department of an institution in the Northeast U.S. facilitated the transfer of hundreds of millions of dollars in less than a year by using the facilities of the U.S. bank. The money transfer operations required a license under State law and federal registration, none of which had taken place. The transfers were between the U.S. and a South American country.
- ❑ Money brokers sent the bank official instructions by fax for transfers to be conducted through dozens of accounts [the official controlled more than 250 accounts].
- ❑ The bank official also controlled accounts of more than 40 shell companies.
- ❑ Wire transfers out of these accounts were payments for goods bought by other companies, which had purchased the dollars through the black market.
- ❑ The bank official used the bank's wire facilities to make the transfers [instructions given to the wire facility also by fax from the bank employee].
- ❑ The money transferred appears to be the proceeds of illegal drug trafficking.

## Case 16

### Credit Card Bust Out Schemes

- ❑ Credit card bust out schemes are normally facilitated through a central subject (sponsor) who enlists the assistance of other subjects (operators) who obtain numerous credit cards from various credit card vendors under the direction of the sponsor<sup>27</sup>.
- ❑ Subjects then boost the credit limit of each credit card to the maximum amount available, usually by initially making legitimate payments on the cards.
- ❑ Credit cards are used to purchase goods and negotiate cover checks<sup>28</sup>.
- ❑ Personal checks are used by the operators under, the direction of the sponsor, to falsely pay off credit card debt (checks are drawn on accounts with insufficient funds). Checks are usually written to reflect the full balance owed on the respective credit card.
- ❑ Additional purchases are made on the credit cards once the check amount has been credited to the account and are completed prior to the actual check returning to the credit card vendor due to non-sufficient funds.

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<sup>27</sup> Sponsors facilitate the operation of the scheme to include providing instructions to operators. Some subjects who serve as operators are sometimes people who initially get involved in the scheme under the belief the sponsor is assisting them in clearing up existing credit problems. The operators use their personal identification to apply for and acquire credit cards that are in turn normally controlled by the sponsors.

<sup>28</sup> Cover checks are negotiable instruments drawn on credit card accounts, sent to the credit card holder (operator) by the vendor. Merchandise purchased through the use of credit cards is sometimes exported to countries tied to the ethnicity of the break out scheme subjects.

- ❑ Many of the operators in the scheme attempt to petition for bankruptcy protection after several successful frauds have been committed through the use of multiple credit cards.

#### Case 17

##### **Cigarette Smuggling in Support of Terrorist Organizations**

- ❑ Law enforcement efforts identified a U.S. cell of a known Middle Eastern terrorist group that engaged in cigarette smuggling.
- ❑ Subjects from the U.S. based cell acquired numerous credit cards to purchase cigarettes in bulk from various cigarette wholesalers.
- ❑ Once purchased the cigarettes were transported to another state within the U.S. with a significantly higher excise tax than the state where the cigarettes were purchased.
- ❑ The cigarettes were sold for profit to a central contact.
- ❑ A senior member of the U.S. based cell often communicated with members of a similar cell operating in another North American country. That cell was identified by law enforcement as acquiring equipment (with possible military applications) on behalf of a known Middle Eastern terrorist organization.
- ❑ A senior member of the U.S. based cell at least on one occasion transferred funds to a member of the other terrorist cell located in another North American country.

#### Case 18

##### Use of Phone Cards to Transfer Value

- ❑ Law enforcement efforts identified a criminal organization that used pre-paid phone cards to front money for a drug transaction<sup>29</sup>. The phone cards were also used to circumvent CMIR requirements<sup>30</sup>.

#### Case 19

##### **Coupon Fraud Used to Possibly Fund Terrorist Organizations**

***Information derived from press reports on first WTC bombings and general statements made by LEA personnel about the investigation.***

- ❑ In the early 1990's law enforcement identified links between a couple fraud operation and the terrorist cell that committed the first World Trade Center bombing.
- ❑ The coupon scheme utilized numerous businesses to falsely redeem thousands of coupons retrieved from news papers, magazines, etc.
- ❑ One of the terrorist subjects assisted in the running of a video store that redeemed thousands of dollars in utilizing the scheme.

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<sup>29</sup> The purpose of the initial drug transaction was to prove to drug traffickers the criminal organization had the funds (value of the phone cards) to purchase drugs from the drug trafficking organization.

<sup>30</sup> As per current federal law, phone cards are not required to be reported on CMIRs despite having a total value in excess of \$10,000.00.



Case 20

Trade Diversion Schemes

(Both hypothetical and case based)

- ❑ An Eastern European company (legitimate or front company) purchases at a deep discount (up to 50%) a million dollars' worth of goods for import.
- ❑ Through its state bank, the company has a letter of credit issued in dollars.
- ❑ The bank of the U.S. exporter receives payment and the goods are shipped to a Western European port for trans-shipment to the final destination.
- ❑ The goods are received by an intermediary company and sent back to the US as "returned U.S. goods".
- ❑ The goods are sold to a U.S. wholesaler at a discount over the U.S. price but generating a profit of \$200,000 to the `importer'.
- ❑ The proceeds of this legal sale can stay in the U.S., go to a Swiss account or anywhere in the world.

Other Vulnerable IVTS Avenues

(Hypothetical)

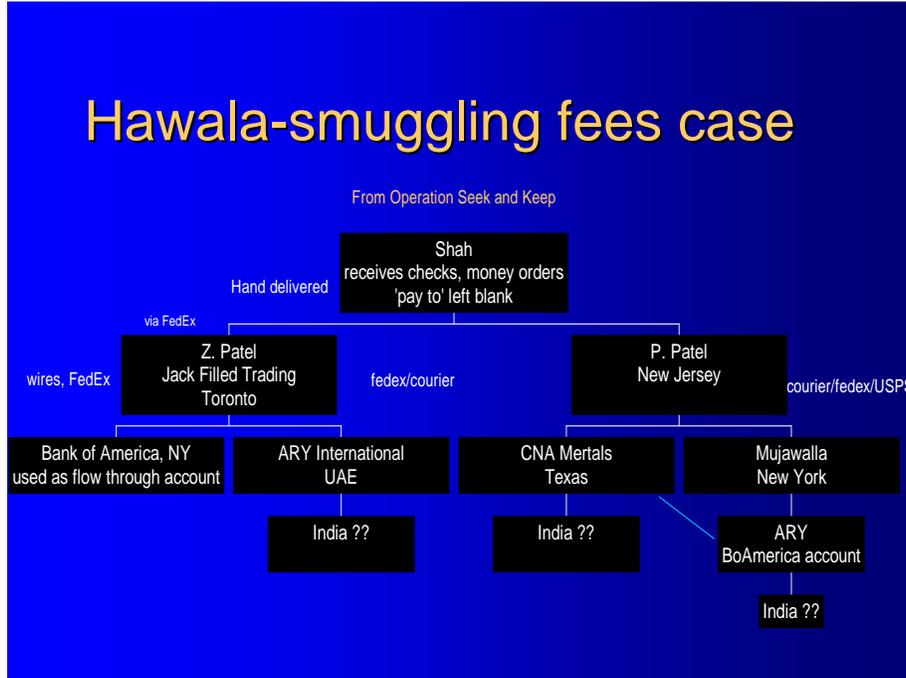
Internet-based Gifts Services

Dozens of websites are offering individuals residing anywhere the possibility to send gifts ranging from flowers and cakes to refrigerators, electronics or even money to scores of countries. The service offered can be extremely swift and efficient. Small and large gifts can be sent through the use of credit card accounts. These internet-based companies by individuals on their own name or that of others, if they wish to move value without leaving traces. They can also be used by IVTS operators for the settlement of their accounts with counterparts. For instance, it is conceivable that a US-based operator repays his debt with a South Asian colleague by sending over electronics or home appliances that can be sold locally in order to fetch the amount that is due. It is also possible that some trader in a third country receives the goods for a triangular (or even more complex "wholesale") settlement process.

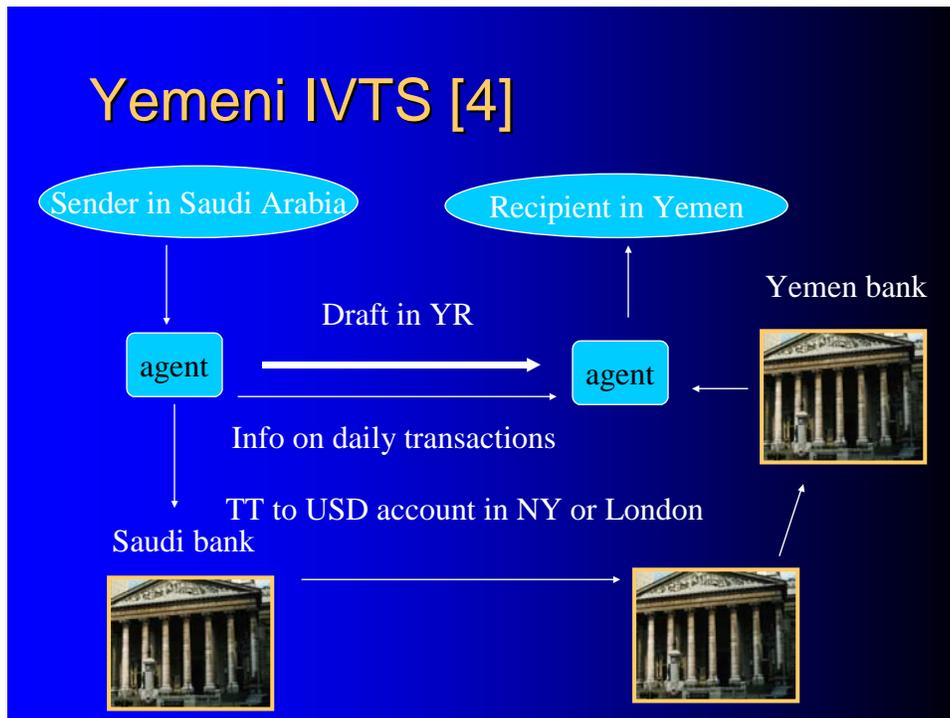
At this point, we are at the beginning of our study in this direction. We are in the process of trying to establish how many such sites are operating, what their turnover is, where gifts are shipped, as well as what kind of information about the customers may be available other than a credit card (which could be stolen, shared or designed to lead to a bust-out fraud).

Case 22

Payment of Human Smuggling fees (from Operation Seek and Keep)

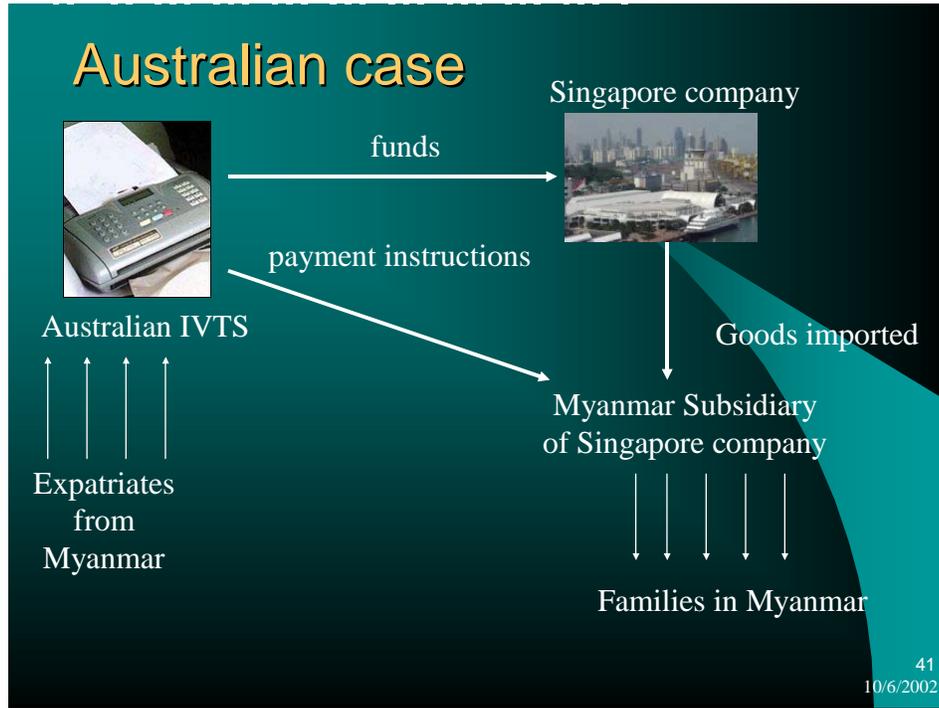


Case 23  
Yemeni IVTS Pattern

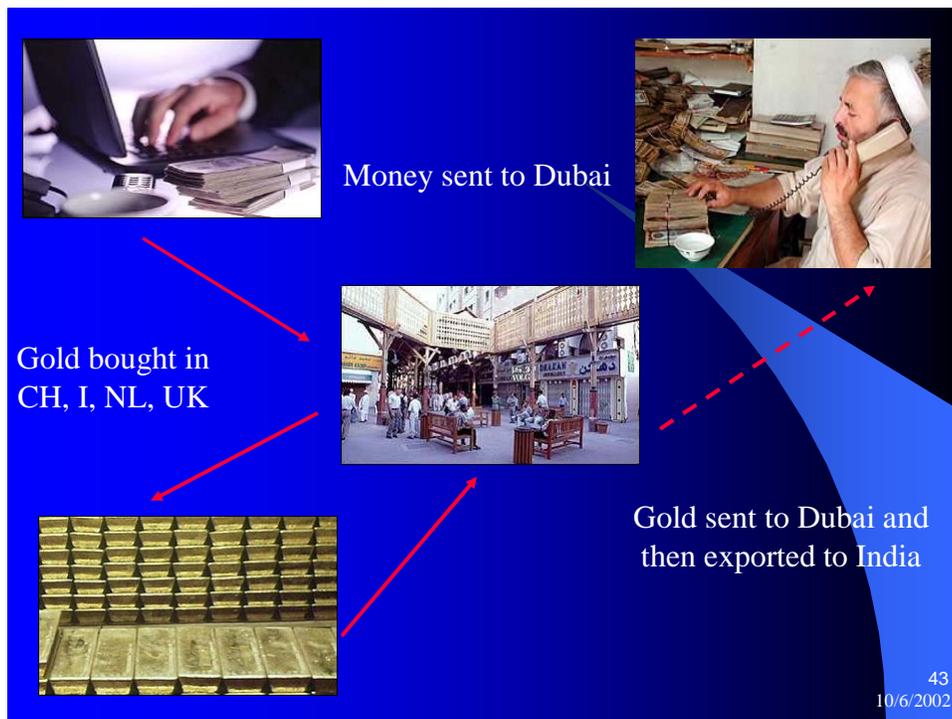


Case 25

Australia-Myanmar case (source APG, 2001).



Case 26  
Settlement through gold smuggling



Case 27 (IN1)

Source of information: police report file in India

State: Punjab, India

Kuljit Singh was the beneficiary of payments made through hawala. He was a member of Kamagata Maru Dal of Khalistan (KMD of K), one of the 26 major terrorist organizations operating in India. KMD International operates in the Kashmir and Jammu region – in the North East of India. According to Indian authorities, this group is sponsored by Pakistan with bases also in the United Kingdom and Germany. At the instigation of a relative, in the early 1990s Kuljit Singh tried to go illegally to Germany and join the "pro-Khalistan elements" that were active there. Because he did not succeed in entering Germany, he traveled back and forth in various other European countries ending up in the United Kingdom. At Oxford detention center, he met Harnek Singh, a former resident of Jalandhar, who urged him to join the Khalistan movement and introduced him to Sewa Singh. Sewa Singh was a member of Kamagata Maru Dal of Khalistan, who used to visit the detention center in order to distribute pro-Khalistan literature and provide monetary help to about 40 sikh Punjabi boys there. Kuljit Singh attended meetings of pro-Khalistan people including the self-proclaimed Prime Minister of Khalistan (JS Chohan) in a Gurdwara (Sikh Temple) in Birmingham in 1997. Not having been granted political asylum by the British government, Kuljit Singh returned to India in 1999 bringing USD 4,000 with him, started working for the KMD of K organization and met with other activists in Punjab.

According to the authorities, he "was working as a conduit and took 2-1/2 kg explosive material from one activist to another in the Organisation." Also, "He was supposed to place a crude bomb prepared from the explosive material outside the office of popular newspaper Daily Ajit at Jalandhar."

Through hawala, he received Rs. 50,000 from Harmit Singh Bhakna, the chief of KMD of K, and passed the money on to Manjit Singh Fauji. The latter introduced him to other activists and, at a later date, gave him explosive material weighing 1 kg. Finally, Singh was arrested on November 8, 1999).

Case 28 (IN2)

Source of information: police report file in India

Another case with very similar interface with terrorist activity: It appears that the transfer of funds for insurgency groups in the Northeast of India is frequently done through hawala channels. We have seen another case leading to the arrest of Gurmukh Singh on May 1, 2001, who received Rs. 1,00,000 [1 USD is 47.8 Indian rupess] from Teja Singh. The arrest was made by Gurdaspur Police, Punjab. Along with Gurmukh Singh four other members of Babbar Khalsa (a pro-Khalistan group) operating from abroad were also arrested. The police were able to recover from Mr Singh a cache of arms, an AK 47 assault weapon with grenade launcher, grenades, pistols, detonators, fuse wire, chemicals, and a revolver. According to the police, the group was planning to create terror in the State of Punjab by targeting, minority leaders, VIPs, vital installations and political leaders.

Case 29 (IN4)

Source of information: police report file in India

**Accused:** Mohd. Muslim alias Gullu alias Sharma  
Jaswinder Singh alias Raju  
**Year:** 1998

1. Jaswinder Singh alias Raju stated that he was an Afghan national. he came to India in May 1997 for treatment of his wife who is also an Afghan national. He has got a firm in the name of M/s Raju Ltd. Latif market, Kabul (Afghanistan) and also in pinto Market at Jalalabad, Afghanistan. He was importing clothes, sewing machines, sweaters and shawls from India, Germany, Russia and France. He went to Pakistan a few times and met Quzan Ali alias Kazi at Akhri Mandi Tang Bazaar, Lahore. In Feb. 1993 Kazi gave him Pak Rupees 60,000. Raju used this money for his business in Afghanistan. On returning to India in May 1998 Kazi of Pakistan instructed him to hand over Indian Rs. 50,000 to Mohd. Muslim alias Gullu of Meena Bazaar (New Delhi). In this deal Raju made a profit of Rs. 8,000.

2. Apart from this, Raju received Rs. 35 Lakh from various persons in India for Kazi during 1997-98 and gave the same to Gullu at a premium of Rs. 500 per month per one Lakh and the said amount was sent to Kazi of Pakistan through Hawala.

3. Mohd. Muslim alias Gullu alias Sharma stated that he was an Indian national. He visited Pakistan in 1990-91 and stayed with a businessman of Lahore named Rizwan. He also stayed with his sister on Karachi. Gullu has a shop in Meena Bazaar (tel.: 328 9325) dealing in cloth. he purchased clothes from Pakistani passengers and Indians on their return from Pakistan and sold them at a profit.

4. Gullu stated that Rizwan of Lahore induced him in to hawala business. Razwan sent Kazan Ali alias Kazi of Lahore to Gullu's shop in India and proposed to do hawala business against a profit of Rs. 200 per transaction per Rs. 1 Lakh. Gullu agreed. He also admitted knowing Raju for last eighteen months or so.

5. Gullu admitted that Raju had made the following payments to him:

Period	Amount delivered to Gullu	profit earned by Gullu
1997-98	Rs. 1,85 crores	Rs. 37,000
May 1998	Rs. 50,000	not indicated
Aug. 1998	Rs. 50 Lakh	not indicated

6. Gullu delivered Rs. 2.35 crores to different persons. Their identities were communicated over telephone by Kazi of Lahore (Pak). The addresses of the recipients were not known to Gullu.

7. During 1997-98 apart from Raju, three more persons (identities unknown) delivered Rs. 75 Lakh to Gullu against which he earned a profit of Rs. 15,000. He distributed Rs. 8 Lakh to Raju of

Dariba, 1.5 Lakh to Khem Singh, 2 Lakh to Kishan Lal and the remaining amount to different persons whose names and/or addresses he did not know.

### **More searches and seizures**

The officers of Special Staff North Delhi conducted some more searches in different areas of Delhi. Rs. 50,000 were seized from Mansoor Ali's place in Pitampura, New Delhi; Rs. 89,000 were seized from Sheikh Parvej Hameed's place in Friends Colony East, New Delhi; and Rs. 47.5 Lakh were seized from a Truck No. JK-03-1398 that was standing between 504/1 Dugru Vihar, Dewali Ext., New Delhi.

The above truck was found to be in occupation of the following:

- 1) Mushtak Ahmed Gilkar alias Haider Ali, R/o House N.A.C. Office, Kishwar, Dist. Doda, Jammu and Kashmir, India
- 2) Mushtak Ahmed Bhatt, R/o Village Tantri Pura, Dist. Anant Nag, Jammu and Kashmir, India
- 3) Faiyaz Ahmed Paddar, R/o Village Aedi Zen Duse, Tehsil Kul Gogu, Dist. Anant Nag, Jammu and Kashmir, India
- 4) Sohail Idrish, R/o Shahidi Mohalla, Dist. Doda, Jammu and Kashmir, India

### **Terrorist funding and Hawala**

Mushtak Ahmed Gilkar alias Haider Ali admitted that the intelligence agency ISI of Pakistan gives Rs. 60-70 crores per year through hawala through a Muslim shopkeeper in Meena Bazaar, Jama Masjid, Delhi (ref. to Mohd. Muslim alias Gullu alias Sharma). He stated that Gullu was an agent of ISI who used to bring money from Pakistan and distribute it to terrorist outfits in Jammu and Kashmir region.

Gilkar also admitted that along with him Mushtak Ahmed Bhatt, Faiyaz Ahmed Paddar and Sohail Idrish received an amount of Rs. two crores in the third week of July, 1998 from Mohd. Muslim alias Gullu alias Sharma in Delhi who was in turn directed by Ali Mohd. Dar took the same to Srinagar and the truck that was seized in the above search was used for the said transaction as well.

Gullu handed over this amount to Gilkar and others near Drayaganj Bridge, Delhi. Gilkar added that though he knew Gullu has a shop in Meena Bazaar, he has never been there himself.

Sohail Idrish also narrated the similar links, amounts and people involved in his confession.

Case 30 (IN5)

Source of information: police report file in India  
(hawala, mis-invoicing and subsidy frauds).

**PEOPLE INVOLVED:**

- *Please note that the names listed below are the name that appeared in the case. The names in upper case letters appear to be the predominant name of these individuals. The names in lower case letters are suspected pseudo-names. However, it is unclear if these alleged pseudo-names were intentional or were simply spelling mistakes on the part of the interpreter.*

**CHANDRASEKHARAN, a.k.a Chandrasekhran, Chandrashekar:** Certified engineer for Rama Enterprises; issued certifications of valuations for exported materials; never checked/ tested product but issued certificate of value- certificates issued on the basis of conversations with Rajnish Aggarwal or Sanjay Aggarwal- also issued certificates for steel balls, alloy steel forgings prearticles- did not check these either.

**GAGAN GOYAL:** Worker at Rama Enterprises in Ludhiana; son of Hira Goyal.

**HIRA LAL GOYAL:** Operator of Rama Enterprises in Ludhiana; father of Gagan Goyal

**JANAK PRASAD SHARMA:** Proprietor of Pashupathi Traders; Nepali national; brought from Nepal for the specific task of opening Pashupathi Traders; sent back to Nepal when Rama Enterprises came under investigation

**JITENDER SHARMA:** Proprietor of Venkateswara Metals (a.k.a Venkestshwara Metal and Sri Venkestshwara); son of Manik Lal Jain; left country in April 2000 for Hong Kong;

**MANIK LAL SHARMA: a.k.a: Maniklal Sharma, Manik Lal Jain, Manik Sharma and Shri Manik Lal:** Proprietor of Maniklal Jain Trading Company (a.k.a Manik Lal Jain Trading Agencies); Employee of Manoj Kumar Jain; accountant and Priest at local Jain Temple; accounts for Manik Lal Jain Trading was opened in the name of Manik Lal.

**SHRI AMIL KUMAR JAIN:** accountant at Jain Enterprises;

**SHRI BIMAL KUMAR JAIN:** operates Jain Enterprises in New Delhi;

**SHRI MANGA REDDY:** worker of Rama Enterprises; accounts for Mahesh Finance Co., Venkateswara Traders, Sairam Trading, Reddy Sales corporation and Roopa investments were opened by Shri Manga Reddy; contact information for some of the above companies were the cell phone and residential numbers of Manoj Kumar Jain;

**SHRI MANOJ KUMAR JAIN, a.k.a. Manoj Jain:** Chartered accountant doing scrap business in the name of Strips India; admitted to receiving payments by cheque and by cash- handed these payments to local persons on instructions from Rajesh Jain.

**SHRI NARESH JAIN:** Proprietor of Kumar Trading; brother of Bimal Jain; based in Dubai; also looks after the activities of Discovery General Trading Co.; Naresh also imported goods into Dubai through Lucky Recycling Co, Tanvi International, T.K. General Trading Co., Western General Trading Co., Silver lines (all under the name of UAE persons).

**SHRI RAJNESH JAIN:** owns Discovery Trading; nephew of Naresh Jain; based in Dubai;

**SHRI RAJNISH AGGARWAL:** manager and signatory of Rama Enterprises; Proprietor of Tanishq Brothers; brother of Sanjay Aggarwal

**SHRI MANISH JAIN:** Proprietor of Jain Traders; son of Manik Lal Jain, brother of Jitender; based in Secunderbad

**SHRI SANJAY AGGARWAL:** Proprietor of Rama Enterprises and Vishnu Trading; brother of Rajnish

### **RAMA ENTERPRISES:**

Rama enterprises, an export business started by Shri Rajnish Aggarwal and his brother Shri Sanjay Aggarwal.

### **Naproxen and Rifampicin:**

Shri Rajnish Aggarwal and his brother (Shri Sanjay Aggarwal) owned and operated Rama Enterprises. Upon the advise of Hamed Ahmed Amali the brothers opened two new companies: Tanishq Brothers and Vishnu Merchants, as well as another firm, Pashupati Traders (named under Janak Prasad Sharma) to export bulk drugs to firms in Dubai. The bulk drugs were stated to be Naproxen and Rifampicin but in actuality were chalk that had been mixed with colouring. Vishnu Merchants and Pashupati Traders exported these “bulk drugs”, (through customs houses) declaring them high value, to Dubai where Shri Rajesh Jain (the Aggarwal’s Dubai contact and partner) would discard the useless chalk and send the monies made on the shipments back through normal banking channels. The monies received would then be distributed through Rajnish Aggarwal to Shri Manoj Kumar Jain, a local Hawala operator, and other persons by cheque or cash. Shri Rajnish Aggarwal and Sanjay Aggarwal would benefit from the duty drawback and export incentives as well as a commission paid by Rajesh Jain. Rajnish Aggarwal would also distribute cheques, as directed by Rajesh Jain and his brother Bimal Kumar Jain to various local persons who contacted him. The monies distributed to local people were paid against the monies received by the exporting of the overvalued chalk powder.

### **Rama Enterprises:**

Rama Enterprises exported, between February 1999 to April 2000, machinery goods, articles of nylon, PVC articles and ready-made garments on consignment to five United Arab Emirate (UAE) firms. The five firms in question are:

- Discovery General Trading Co (Ajman); owned by Shri Rajnesh Jain and Shri Naresh Jain
- Lucky Recycling Ltd. (Dubai); owned by Shri Abid
- Tanvi International (Dubai); owned by Vinay Goel

- T.K. General Trading Co. (Ajman); owned by T.K Jain
- Western General Trading Co. (Dubai); owned by ?

Total value of these exports was Rs. 27,37,38,309.

### **Exporters and Suppliers:**

- The goods were primarily supplied by: Hi-Tech Processors (Delhi), Anand Fasteners & Mechanical Works (Dehli, Ludhiana), Omkar Steel Traders (Dehli), Rattan Gears (Faridabad), Vijay Trading Company, Satvahana Ispart (Hyderabad), Taxila Spinners, SMB Hardware, Satyam Sales (Ludhiana), A. Kallappan Trading (Madhurai) and Shivam International (Dehli).
- The supplied goods were sent through various shipping houses and forwarders, namely: Seagull Shipping Services, Choice International, World Gate Exporters Lines Pvt. Ltd, Sapthasagar Shipping.

### **Tracing the Money:**

#### **General Overview:**

Supplies, such as ready-made garments, machinery goods, articles of Nylon and PVC articles, were exported through Rama Enterprises to companies in the United Arab Emirates. Before being shipped, Chandrasekharan, an engineer who worked for Rama Enterprises, issued valuation certificates while Rajnish Aggarwal (manager of Rama Enterprises) signed the export papers stating that the goods were high value, high precision items. However, this was not the case as all the exports were proven to be either overvalued or non-existent. These exports were then shipped to five firms in the United Arab Emirates as directed by Rajnesh Jain, their contact in Dubai. Rajnesh Jain returned the monies made on the shipments (money from export incentives and payments for fake goods) via normal banking channels. The banks involved in this particular part of the case were Tamilnadu Mercantile Bank Ltd, HDFC BANK and Centurion Bank. Once the monies were in the accounts Rajnesh Jain instructed Rajnish Aggarwal to issue blank cheques for predetermined amounts and give them to persons sent to him by Bimal Kumar Jain, Rajnesh's brother. Additionally, some of the monies made from the exports were to be given to Bimal Jain who would in turn send the money back to Rajnesh Jain in Dubai. Apart from the local payments, cheques were also sent to the alleged supply companies as payment for materials.

The Directorate of Revenue Intelligence also investigated the other export company, Tanishq Traders. However, in this case Shri Rajnish Aggarwal reported much of the information and paperwork detailing the operational side of the business as being washed away in flash flooding. What is known about Tanishq Brothers is that they exported 25 consignments of machinery parts and ready-made garments to the same customers as Rama Enterprises. Cheques were issued from the account of Tanishq Brothers to: Shivan International, Ajit Engineering Works, Jain Traders, Anand Fasteners, Hi-tech processors, Omkar Steel Traders, Sri Sai Auto Engineering, all of whom were claimed as suppliers to both Rama Enterprises and Tanishq Brothers. Accounts opened in the name of Manga Reddy, from which Rama Enterprises and Tanishq Brothers were credited, issued payment to non-existing suppliers. These payments were paid to Manoj Kumar Jain through cheques given to Manik Lal. Shri Rajnish Aggarwal had adjusted the amounts he paid to local persons by enhancing the value of the goods he was exporting. Both Rama Enterprises and Tanishq Brothers issued cheques in the name of Shivam International and handed them over to Bimal and Naresh Jain. Rajesh Jain, from Dubai, sent monies made from the foreign exchange to

Rajnish Aggarwal as inward remittance for adjustments of the amount being paid to Bimal Jain and Manoj Lal.

### Suppliers, Exporters and Compensatory Payments

After the receipt of payments in the guise of export proceeds, cheques were issued in the name of non existent firms which were further endorsed in the name of the below mentioned firms. The amounts were withdrawn from these accounts by Manga Reddy to facilitate compensatory payments by him as per the instructions of Rajesh/ Naresh Jain of Dubai. The officers of the Directorate of Revenue Intelligence (DRI) found that all the cheques issued by Rama Enterprises to the parties which Rama claimed as their suppliers were endorsed to specific firms namely: Mahesh Finance Co., Sri Venkateswara Traders, Sairam Trading. However, cheques issued to the firms of Jain Traders, Espee Steels Pvt Ltd., Om Shanti Satins, Shivam International, Taxila Spinners and Vibhav Udyog were not endorsed. It was determined by the DRI that at least four of the supply firms: A. Kallappan Trading, Anand Fasteners & Mechanical Works, Satyam International and Shivam International, was fictitious. Jeevam Kumar was named as the account holder of Shivam International. However, it was determined that no such person existed. It was further found that Espee Steels Pvt. Ltd., Satavahana Ispat, Rama Sections Pvt. Ltd and Om Shanti Satins were not suppliers of Rama Enterprises.

The DRI also found that all the cheques issued to these parties were cleared in Agrasen Co-operative Urban Bank Ltd. All of the cheques were endorsed to Mahesh Finances Trading. Mahesh Finance Co., Venkateswara Traders, Sairam Trading, Reddy Sales Corporation and Roopa Investments were all under the name of Shri Manga Reddy. However, the bank that all the issued cheques were cleared in was Agrasen Co-operative Bank Ltd. The Chairman of this bank, Shri Siva Sankar Aggarwal, is a close friend of Shri Manoj Kumar Jain. It was Siva Sankar Aggarwal's son, Shri Kapil Aggarwal that made the self- introduction to the branch manager (Shri Yogesh Aggarwal) that allowed Manga Reddy to open accounts for his businesses. As previously mentioned, all cheques cleared by Agrasen Bank were for the export suppliers. However, Agrasen Bank also cashed cheques, issued to other people, to Manga Reddy, these cheques were bearer cheques. Manik Lal also cashed bearer cheques issued by Jitender Sharma and Manish Jain.

Manoj Jain assisted Rajnish Aggarwal in opening an account in Manga Reddy's name so that cheques issued by Rajnish to his suppliers were cashed on the Manga account. Cheques were endorsed in the name of Reddy Sales Corp. and the cash was handed over to Rajnish Aggarwal. He then used that money to pay local people. Rajnish Aggarwal was instructed by Rajesh and Naresh Jain to open a separate account in the name of Jain Traders. Through this account, Rajnish Aggarwal issued cheques in different firms names, endorsed by Jain Traders, and utilized the money from the cheques to pay local people. Additional accounts opened in the name of Venkateswara Metals and Manik Lal Jain Trading Agencies were opened for the same purpose.

### Findings of the Investigation (as directly quoted in the case):

1. All the exports made by Rama Enterprises and Tanishq Brothers are nothing but bogus and exports of substandard goods made for the purpose of claiming draw back amounts from the Customs authority and to make compensatory payments.
2. All the firms and persons, except a few, figured in the bank account statements of Rama Enterprises and Tanishq Brothers and claimed as suppliers are non existent but invoices were raised in their names by these two firms, only to facilitate withdrawal of money

received as the export proceeds in to the accounts of Rama Enterprises and Tanishq Brothers by Manoj Kumar Jain and Bimal Kumar Jain.

3. The goods they exported by declaring them as high precissioned [sic] were of actually not high quality but of ordinary goods of junk quality.
4. The commission shown to have been extended is only to enhance the value of the goods and thereby claiming more draw back amount.
5. The amounts withdrawn from the accounts of Mahesh Finance Co., Reddy Sales Corporation, Sairam Trading, Venkateswara Traders, Jain Traders, Ventateswara Metals and Mainiklal Jain Trading Co., by endorsement of the cheques issued by Rama Enterprises and Tanishq Brothers were used by Manoj Kumar Jain for making compensatory payments on instructions from Naresh Jain and Rajesh Jain.