

# Informal Value Transfer Systems and Criminal Organizations

## A study into so-called underground banking networks

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### Executive summary

This report presents the findings of a preliminary study into what is commonly called "underground banking systems". The study was funded by the Research and Documentation Centre of the Dutch Ministry of Justice, which acted on the advice of the Advisory Committee for Research on Organized Crime. As the conventional banking industry is increasingly being regulated, many fear that criminal organizations may turn to alternatives, such as "underground banking systems", in order to avoid detection. The main goals of the study were to provide a policy-useful analysis of the way in which such systems operate, the extent to which criminals may resort to their services, and the policies adopted by different governments.

This relatively short study did not start with many ambitions of generating new and original data. Rather, the objective was to take stock of what is known about the issue, to separate myths from reality about the problem, and to offer a first assessment of the risks posed by "underground banking systems". This should give a good indication as to whether urgent measures need to be taken or more research is necessary before considering any policy or legislative adjustments.

The methods for this project consisted in a combination of archival, legal and historical analysis with unstructured interviews with regulators, law enforcement agents and academic or other experts from the USA, Canada, Britain, France, Australia, Hong Kong, Germany, South Africa, India and Russia. First of all, an attempt is made at conceptual clarification. There are many terms to describe the practices in question e.g., hawala, hundi, fei ch'ien, depending on the ethnic group involved. These practices do not involve traditional banking transactions or services, like deposit taking or lending. Instead, these are essentially mechanisms serving the transfer of value from place to place. Moreover, they are not at all "underground" in many parts of the world. In many cases, it is, therefore, suggested that the term "informal value transfer systems" (IVTS) is more appropriate for our purposes than "underground banking". IVTS is defined as any system or network of people facilitating, on a full-time or part-time basis, the transfer of value domestically or internationally outside the conventional, regulated financial institutional systems.

Most contemporary forms of IVTS have evolved out of two main variations, the South Asian and Chinese methods of value transfer, both of which originated centuries ago. Following a presentation of the historical roots and evolution of these two prototypes, a more contemporary Colombian modus operandi is outlined, which emerged in the context of the black market for pesos. The mechanics of each of these IVTS are briefly sketched, while six contemporary variations are both described and graphically represented. The most basic method is when a client wishes to send money to a relative in another country. He gives it to a local IVTS agent, who calls or faxes instructions for payment to his counterpart in the relative's city. His counterpart makes the payment in a matter of hours and balances his account with a transfer in the opposite direction. When the transfers are of unequal value, from time to time the IVTS agents may wire transfer the difference. More complicated ways of balancing the books involve invoice manipulation and trade in consumer items, gold or other commodities.

Unfortunately, a lot of the conventional wisdom was found to be misleading or false. Contrary to widespread beliefs that IVTS sprung from political turmoil or that they began as ways of violating currency controls and other laws, their origin was found to be rather benign. They served people well before the development of modern banking institutions, they facilitated legitimate trade or other transactions, while protecting against robbery and theft in highways. They were so widely accepted that they became integral elements of the culture in Asian countries and communities of immigrants. Other errors in conventional wisdom include the assumption that IVTS are usually surrounded by violence and corruption, and that high technology may be used in the near future for more secrecy and confidentiality. The evidence suggests that typical IVTS operations are smooth, consensual and require only low technology, such as a telephone or fax machine.

Such inaccuracies in conventional wisdom come about by a process described as "facts by repetition". That is, erroneous statements were included in widely circulated articles, which were later reproduced in other media articles, government reports, academic publications, and even United Nations documents. This problem, which is regrettably common in analyses of transnational and other serious forms of crime, points to the need for critical reading of internet and other publications, as well as the importance of triangulation.

As Asian ethnic groups immigrated to the four corners of the earth, the necessary infrastructure for IVTS expanded. Many factors contribute to their popularity as remittance methods among certain ethnic groups to this day. They range from the absence of conventional banking facilities in many parts of the world to the distrust in ordinary banks or government policies, discrimination, currency controls, and the confidentiality of IVTS. Many people resort to IVTS because they simply follow cultural traditions or simply because their services are faster, cheaper, less bureaucratic and more convenient than any other alternative.

Although IVTS originated in Asia, they are now found to operate in every continent. The extent of IVTS operations is highlighted in the report by reference to media and government publications regarding several countries.

Given the wide availability and convenience of IVTS together with the anonymity they offer, it is no wonder that intelligence agents and criminals also enjoy their services. Indeed, evidence is cited in this report of use of IVTS for the facilitation of capital flight, tax evasion, covert operations, corruption, intellectual property violations, ransom collection, financial fraud, terrorism, smuggling of illegal immigrants, money laundering, as well as illegal trade in drugs, body parts, arms or commodities. Case examples for each type of such illegal transactions are given from various countries with a word of caution about the reliability of many journalistic or other sources that were not triangulated in the short period of this study.

It is by no means suggested that IVTS are infested or controlled by criminals. All that can be proven is that IVTS is no more than one of numerous alternatives available to individual offenders and criminal organizations. As a matter of fact, it appears that other options money laundering or transfers are preferred by criminal organizations, as IVTS cannot handle easily or at all the substantial amounts of money generated by illegal enterprises. These alternatives include conventional banks, insurance companies, non-bank financial institutions (e.g., bureaux de change and money remitters), real estate and gold transactions, and currency smuggling.

An area of substantial controversy is the extent and growth of IVTS business. There are no reliable estimates and no hard evidence for proper assessment. Consequently, many of the figures that have been put into circulation by reporters or government agencies either come out of thin air or are based on anecdotal evidence. The best we can do is probably clearly establish all the conditions contributing to the use/growth of IVTS and then conduct studies inquiring into the existence and strength of such factors. Interviewees of equal standing and integrity have argued in opposite directions. There is wide agreement that what is known constitutes only the tip of an iceberg. For some observers, though, this iceberg is much bigger than for others. Nevertheless, it has been persuasively argued that IVTS are unable in most cases to transfer very high amounts of money, while many criminals find that money laundering is not necessary, as it can be easily integrated in local economies. These facts, together with the availability to criminals of many other alternatives, suggest that the IVTS-related crime and other risks may have been exaggerated.

Authorities in Third World countries have been concerned about negative effects of IVTS to their economy and government policies. Capital flight and tax evasion, in particular, have worried officials in the South for a long time although it must be added that IVTS also perform useful functions in times of crises, as they provide safety valves and added liquidity. The more recent official concerns in Western countries stem from the perception that IVTS are increasingly becoming a vehicle for money laundering and other offenses. So, as IVTS generally do not break any laws in the West, they had been left more or less alone in the past. The war on drugs and the anti-money laundering movement have changed this. Yet, the newly found agreement that IVTS is an issue is neither founded on solid evidence nor has it led to harmonized policy approaches.

Many IVTS practices are misunderstood and treated with suspicion even when nothing illegal or unethical is involved. The lack of unified approach is due to the diverse interests of the West and the South. The best illustration of the problem is when South Asian countries tried to discourage the use of IVTS by advertizing bearer bond certificates with no questions asked about the origin of the money. This de facto facilitated the laundering of dirty money, exactly the problem for which IVTS are now targeted in the West. Such misunderstandings and lack of policy co-ordination may be remedied through careful studies into IVTS and their effects on society and wide dissemination of the results. Better awareness of the respective concerns, national interests and policy priorities can pave the way

for improved collaboration among national and international control bodies.

In order to further this aim, the report also provides a brief overview of laws and practical measures taken by a number of countries. In general terms, Western governments have attempted to render IVTS more transparent and required them to get a license and report or record unusual transactions of certain magnitude. In the West, IVTS-related policies are closely linked to the issue of money laundering, and governments have not taken any specific action against IVTS. Some of these measures may actually affect certain formal and regulated business, which would be faced with additional operating costs. For this reason, proposals for further regulation of non-bank financial institutions in the USA have been met with strong opposition by money remitters, such as Western Union and American Express (the dialogue between the authorities and money remitters on the proposed rules continues). In the South, on the other hand, governments have tried to take money out of the informal economy and bring business to their (often inefficient) conventional financial sector by encouraging non-resident citizens to invest in bearer bonds with tax and other privileges. They have also liberalized (at least partly) the gold trade, which is intimately linked with many Indian and Pakistani IVTS operations. Yet other countries, such as China, have attacked the whole unofficial banking sector, but not specifically the IVTS businesses (which essentially bring value into the country).

The extent and consequences of IVTS seem to vary significantly from country to country. Therefore, it makes sense for each country to review carefully the facts, risk and interests involved before making policy decisions and implementing measures that might backfire or prove to be overkill. Country studies could employ archival/historical analysis along with participant observation methods and in-depth interviews with knowledgeable controllers and citizens. In addition, import and exports statistics can be analysed for the detection of invoice manipulation indicative of IVTS activity. Finally, where available, remittance patterns can be analysed in order to ferret out any transfer of value out of a given country that corresponds to amounts larger than the legitimate income of the senders.

There is no doubt that IVTS are used by criminals. However, an important, albeit preliminary, conclusion is that IVTS do not seem to represent a cause for grave concern in the Netherlands and most countries. Spectacular and publicized cases involving criminal abuses of IVTS appear to be atypical and, thus, should not lead to hasty decisions and draconian measures. Some measures may be counterproductive or involve unnecessary invasion of innocent people's privacy. They may also give the impression that the cultural traditions underpinning IVTS are unfairly attacked. So, before implementing drastic measures, more solid evidence of negative consequences is required. The legislative arsenal in the West can adequately deal with those who have committed crimes. After all, criminals are the main problem, not the way they move their money.

Criminal laws appear to be the least effective way of dealing with IVTS. Some have recommended the extension of money laundering legislation (e.g., know your customer rules) to cover IVTS. Critics point out that the operation of IVTS will be unaffected, while more people (clients) would be needlessly criminalized. It is also essential to bear in mind that IVTS are often the only channel through which immigrants can send funds to assist their families in the homeland.

The report concludes with a host of regulatory, public policy and training issues that may be considered. The most effective policies would be those going to the heart of the problem: government over-regulation, discrimination, political and economic crises, inflexible bureaucracies, high taxes, unfriendly, inefficient, expensive or lacking banking services, lack of confidence in a given country's economic system and banks. In the South, the most effective measures seem to be improvements of the formal banking sector, consistency in economic and other public policies, a higher degree of economic liberalization (especially with respect to precious metals, interest and currency exchange rates) and fewer currency and other regulation.

To be sure, these are long-term objectives. In the meantime, regulations may be extended to cover IVTS activity, but care ought to be taken to avoid the application of ethnocentric rules that may alienate ethnic groups. Licensing or record-keeping requirements can be contemplated and discussed openly with representatives of the communities concerned. Banking institutions may also be approached to assist with the detection of IVTS suspicious or unusual transactions (many IVTS hold bank accounts).

Police need also to be trained to be more sensitive to other cultures as well as to be able to identify IVTS patterns and irregular (possibly criminal) transactions.

Finally, given that the issues are mostly international in nature, better collaboration and exchange of information among control agencies is needed. This can be achieved by paying attention and respecting in practice the interests, priorities and policies of all countries concerned.

The report ends with the recommendation that, regardless of what measures and policies a government opts for, evaluation tools should be provided, in order to monitor the progress, successes

and failures as objectively as possible.