A guidance to understand hawala and to establish the nexus with Terrorist financing
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**Acronyms**

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<td>Financial Action Task Force</td>
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<td>TF</td>
<td>Terrorist financing</td>
</tr>
<tr>
<td>AML</td>
<td>Anti-Money Laundering</td>
</tr>
<tr>
<td>CTF</td>
<td>Counter Terrorist financing</td>
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<tr>
<td>IVTS</td>
<td>Informal Value Transfer System</td>
</tr>
<tr>
<td>IVTM</td>
<td>Informal Value Transfer Mechanism</td>
</tr>
<tr>
<td>IFTS</td>
<td>Informal Funds Transfer System</td>
</tr>
<tr>
<td>FINCEN</td>
<td>Financial Crimes Enforcement Network</td>
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<tr>
<td>NPO</td>
<td>Non-profit Organization</td>
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<td>KYC</td>
<td>Know Your Customer</td>
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Executive Summary

The global financial system is vulnerable to money laundering and terrorist financing risks. After the unfortunate events of 9/11, jurisdictions are constantly developing new rules and regulations to mitigate these risks, especially the risks of terrorism. Without the necessary funding, terrorists cannot commit their crimes, making the delivery stage of terrorist financing the most crucial stage. Seeing the growing stringent regulatory framework, bad actors constantly seek new ways to move the funds for terrorism funding purposes, which is either obtained legitimately or illegitimately. Informal Value Transfer Systems (IVTS) have become a preferred way to move around funds, for not only money launderers, terrorism financiers but also for immigrants who must support their families back home.

IVTS refers to “any system, mechanism, or network of people that receives money for the purpose of making the funds or an equivalent value payable to a third party in another geographic location, whether or not in the same form. The transfers generally take place outside of the conventional banking system through non-bank financial institutions or other business entities whose primary business activity may not be the transmission of money.” There are several types of informal value transfers systems. In addition, IVTS has been classified as underground banking and alternative remittance systems. This paper will discuss Hawala, a widely form of IVTS.

Due to its lack of bureaucracy, lack of paper trail and no Know Your Customer (KYC) documentation, bad actors have come to favor this type of remittance system. However, the biggest risk is the unlicensed remittance service providers. The challenges faced by jurisdictions, law enforcement and financial institutions in detecting unlicensed hawala service providers as well as lack of information of the concept make it difficult to assess the amount of funds that are moved through this type of remittance system.

There is a growing nexus between terrorist financiers and the abuse of hawala. There exists a similar yet different perspective on hawala amongst scholars, making it difficult at times to mitigate the risks of being used in terrorist financing. The fact that hawala circumvents AML/CTF measures to facilitate both legitimate and illegal funds, makes it more difficult to detect the funds linked to terrorist financing.

Jurisdictions are recommended to conduct more research on hawala and invest in training for law enforcement. In addition, jurisdictions should evaluate on Financial institutions are recommended to look for red flags for hawala when monitoring accounts.
Background

On January 10, 2018, a 37-year-old suspected Lashkar-e-Taiba (LeT) militant, allegedly involved in the 2000 Red Fort terror attack, was arrested at Delhi airport by a joint team of the Delhi Police special cell and anti-terrorist squad (ATS) of Gujarat Police. The 2000 Red Fort attack was a terrorist attack on Red Fort in Delhi India. The attack was an apparent attempt to derail India-Pakistan peace talks. This act was committed on December 22, 2000. It was carried out by Pakistani terrorist group LeT. It killed two soldiers and one civilian. The Red Fort is also significant historically as it was taken over from British control and is an iconic site in India. Police claim the accused, Bilal Ahmed Kawa, was the same person they had been looking for since the day of the attack on December 22, 2000. According to police, during investigations they learnt that Rs 29.5 lakh was transferred through hawala and through various bank accounts in Bilal Ahmed’s name. This amount was deposited in Bilal Ahmed’s account by Mohammad Arif alias Ashfaq Ahmed, the mastermind of the Red Fort attack. Ashfaq Ahmed received the money through hawala from his handlers apparently based in Pakistan. The money was utilized in the funding of the terror attack, police said.

Hawala is a widely used form of informal value transfer, especially in countries lacking a financial system or containing various areas not served by formal financial systems. In such countries and areas, Informal Value Transfer Systems may be the only method for financial transactions. While it appears that the majority of IVTS activity is legitimate in purpose, these systems have been used to facilitate the financing of terrorism and in furtherance of criminal activities. The preceding statement is sustained by the previous news article excerpt. IVTS, also referred to as underground banking pose one of the biggest money laundering and terrorist financing challenges in the (US) financial system, despite global efforts to increase AML/CTF & KYC awareness. However, it is not only a challenge for the US/western financial system but also for Arab and Asian economy. According to Dennis Lormel, “the biggest concern of financial institutions is to be able to identify customers who are engaged in illegally transferring money from others”.

This paper seeks to provide proper understanding of the basics of Hawala, its operations, and red flags for financial institution to detect this within their operations.

Prior to determining if hawala is used as a conduit for terrorist financing, one must have a basic understanding of terrorist financing itself, the stages and its methods.

---

1 Lashkar-e-Taiba (LeT), also known as Army of the Pure or Army of the Righteous, is an Islamic militant organization based in Pakistan. It was founded in 1990 by Hafiz Mohammed Saeed as the military wing of Pakistani Islamist organization Markaz-ad-Dawa-wal-irshad (MDI), which promotes the Ahl-e-Hadith (AeH) interpretation of Islam, until it ostensibly split from the group in 2002.  
4 Mr. Lormel provides consulting services and training related to terrorist financing, money laundering, fraud, financial crimes and due diligence. For 28 years, he served as a special agent in the FBI and served as chief of the FBI Financial Crimes Program. There, he formulated, established and directed the FBI’s terrorist financing initiative following the terrorist attacks of September 11, 2001. For his visionary contributions, Mr. Lormel received numerous commendations and awards to include the Department of Justice, Criminal Division’s Award for Investigative Initiative and the Central Intelligence Agency’s George H. W. Bush Award for Excellence in Counterterrorism.  

Terrorist Financing

The Financial Action Task Force (FATF) defines terrorist financing as “the financing of terrorist acts, and of terrorists and terrorist organizations”\(^5\). Terrorists require financing to commit their acts. Most importantly they need methods or systems to move these funds around.

One may be inclined to suggest that such terrorists use underground banking as a conduit, simply because it will be more difficult to make use of the traditional banking system. This is in part true. Research after 9/11 indicates that terrorists used the traditional banking system to raise and move funds. As a matter of fact, the Islamic State (IS) currently uses both the local financial system and the global financial system to fund their activities.

The long-term financial health of a terrorist organization will impact its operational tempo, its reach, and the robustness of its campaign of violence. This is clearly visible with ISIL. Money and value goes in and out of Syria and Iraq ISIL-controlled areas, from ISIL and their leaders to conduct trade, most of which is attached in some way to accounts at financial institutions. In many instances, detection occurs, after the event.

Terrorist financing consists of three stages:
1. Funding Stage;
2. Delivery Stage; and the
3. Terrorism Act.

The most critical stage is the second stage. The stage in which the terrorist organization or terrorist cell acquires the funds to complete the terrorist act, the third stage. Without the delivery stage, such horrible events can never take place.

The first stage is of importance when the person or legal entity can deliver the funds to the terrorists. If countries are able to implement barriers and, to some extent, eliminate the conduits to be used in the delivery stage, such terrorist organizations will be neutralized.

It is imperative that financial institutions acquire more knowledge of the delivery stage, specifically to identify the mechanisms, both formal and informal, that are used to move terrorist funds.

Why is this important? According to recent studies, the theoretical value of assets under ISIL control (oil reserves, gas reserves, minerals, cash assets) was estimated at $ 2,260 billion by the end of 2015.\(^6\) According to a report, published by the Center for the analysis of terrorism, ISIL derives its financing from extortion and currency transfers from Iraq and Syria reaching Libya, either through smugglers or via the hawala system.\(^7\)

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\(^5\) Glossary of the FATF Recommendations

\(^6\) Center for the analysis of terrorism (2015), ISIS Financing. 

\(^7\) Center for the analysis of terrorism (2015), ISIS Financing. 
Sources of Terrorist Financing (TF)

In general, previous research has shown that terrorist organizations rely on numerous sources of income and that they use a range of methods to move funds, often internationally, to their destination/beneficiary without being detected. The sources for terrorist financing can be divided into categories of legitimate and illicit. The below overview presents a non-exhaustive summary:

<table>
<thead>
<tr>
<th>Sources of TF</th>
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<tbody>
<tr>
<td>Legitimate</td>
<td>Illicit</td>
</tr>
<tr>
<td>(fake) Charities proceeds</td>
<td>Human trafficking</td>
</tr>
<tr>
<td>Businesses</td>
<td>Drug trafficking</td>
</tr>
<tr>
<td>Fund raisers</td>
<td>Extortion &amp; kidnapping</td>
</tr>
<tr>
<td>Contributions from (wealthy) individuals</td>
<td>Taxes</td>
</tr>
<tr>
<td>Financial assets</td>
<td>(Bank) robbery</td>
</tr>
<tr>
<td>Religious groups</td>
<td>Smuggling of gold, precious stones and other goods</td>
</tr>
<tr>
<td></td>
<td>Proceeds of oil, oil products and gas</td>
</tr>
</tbody>
</table>

Movements of the Funds

The next question that arises is, how will the generated funds be moved? Financial institutions that provide the service to move funds are vulnerable to be used as a method to move the terrorist funds. The implications go far beyond, as they portray a negative image of the financial institution and the jurisdiction it operates in. On a global scale, it poses a threat to peace and security.

Research indicates that cross border transactions are needed to move funds between local groups and international groups. Funds are required to pay for travel expenses, purchase of bomb making materials, housing, food, internet accesses, communications and transport. In case of a domestic attack, the amounts will be smaller, may not always require cross border transactions and will be much more difficult to detect.

The preferred methods to move funds are among others:

- Bank and wire transactions
- Informal Value Transfer Systems (IVTS)
- Cash couriers
- Virtual currencies
- Internet based payments
- Prepaid debit cards

Methods to move the terrorist funds continue to evolve in response to changes in technology and/or the legislative climate. There is an increase in efforts to deliberately circumvent law enforcement and AML/CTF measures. The banking industry remains a reliable and efficient way to move funds internationally. But, without proper mechanisms in place, traditional products offered by banks, can be abused for terrorist financing. For example, sympathizers of a terrorist group can open savings accounts and provide the debit cards associated with the accounts, to a member of the terrorist organization to enable access to cash via withdrawals from overseas bank ATMs.

Genesis J. Martis

7
Jurisdictions with active terrorist groups and areas where the financial infrastructure is limited, creates a situation in which informal remittance systems become the primary financial system through which customers can engage in cross-border funds transfer activity. The vulnerability lies in the unsupervised remittances or those that operate without the proper business license.

Migrant communities and their families back home, rely heavily on informal remittance systems (informal value transfer systems) to remit funds home. Bad actors see this as a gateway to move/launder their funds. Consequently, the funds destined for terrorism and legitimate funds for family overseas are being mixed, making it difficult to distinguish between the legitimate and illicit funds.

Terrorist groups aim to hide the nexus between the source of the funds and their eventual destination or purpose. The most common methods been detected in relation to terrorist financial activity:

- Front Companies – companies which carry on business where illegal profits can be co-mingled with revenues derived from legitimate profits.
- Shell Companies – businesses without substance or commercial purpose and incorporated to conceal the true beneficial ownership of business accounts and assets owned.
- Nominees – use of family, friends or associates who are trusted within the community, and who will not attract attention, to conduct transactions on their behalf to disguise the source and ownership of funds.
- Structuring (smurfing) – depositing of cash or purchasing of bank drafts at various institutions by several individuals, or the carrying out of transactions below reporting thresholds.
- Electronic Funds Transfer – use of wire transfer services to transfer funds to associates.
- Currency Smuggling – the physical movement of cash from one location to another to disguise its source and ownership.

**Informal Value Transfer Systems (IVTS)**

Abad Elfgeeh, an American citizen born in Yemen, was operating an ice cream shop in the US. The annual revenue of his business was $185,000. But the ice cream shop illegally wired $22 million overseas, mostly to Yemen. Elfgeeh, used an account with a major bank to wire money overseas for Sheik Mohammed Ali Hassan al Moayad. Al-Moayad was a member of al-Qaeda. He was the self-proclaimed spiritual advisor to Osama bin Laden. Elfgeeh claimed he was not running an unlicensed money transmitter business but providing a “community service”. The ice cream shop named “Carnival French Ice Cream Shop”, operated as an unlicensed and unregistered money transmitter.

See below a transaction breakdown of this case:

- $22.2 million was deposited by cash, checks and wire transfers into 12 accounts held at multiple U.S. banks from 1996 through 2003.
- The deposits were structured to avoid reporting requirements.
- Funds were subsequently consolidated into central account in the U.S. using checks and wire transfers from the 12 accounts.

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9 Carnival Ice Cream Shop case provided by Mr. Dennis Lormel, CAMS.
• From the central account, $21.9 million was wired to accounts in 25 countries on behalf of customers in the U.S.

The service providers, better known as (hawaladars) who controlled recipient accounts in those countries then exchanged the funds into local currency and distributed payments to intended beneficiaries.\(^{10}\)

The aforementioned is a typical example of funds being processed by the so-called Informal Value Transfer System (IVTS), specifically hawala. The moving of funds and value transfers from place to place on behalf of legal actors, terrorists or other criminal groups that take place informally or without leaving many obvious traces (or at all), have been referenced as IVTS\(^{11}\). Hawala is a type of IVTS.

Hawala is interpreted in several ways and has different meanings in several jurisdictions. Note that there exist a variety of IVTS.

The most important IVTS identified so far are:

<table>
<thead>
<tr>
<th>Non-exhaustive list of IVTS(^{12})</th>
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<tr>
<td>Hawala</td>
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<tr>
<td>Hundi</td>
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<tr>
<td>Black market peso exchange networks</td>
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<tr>
<td>Fei chien, door-to-door, and other Asian varieties</td>
</tr>
<tr>
<td>Invoice manipulation schemes</td>
</tr>
<tr>
<td>In-kind fund transfers (India and elsewhere)</td>
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<tr>
<td>Bank guarantee</td>
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<tr>
<td>Brokerage accounts</td>
</tr>
</tbody>
</table>

**Terminology**

The Financial Crimes Enforcement Network (FinCEN) advisory of March of 2003, defines IVTS as:

> “any system, mechanism, or network of people that receives money for the purpose of making the funds or an equivalent value payable to a third party in another geographic location, whether or not in the same form. The transfers generally take place outside of the conventional banking system through non-bank financial institutions or other business entities whose primary business activity may not be the transmission of money.”

References to IVTS indicate that transactions occur outside of the conventional banking system. The terms “underground banking” and “alternative remittance systems” are inaccurate and is recommended not to be used to identify hawala transactions. More information will be provided in the section of “Hawala Myths”.

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\(^{10}\) Carnival Ice Cream Shop case provided by Mr. Dennis Lormel, CAMS.

\(^{11}\) Nikos Passas (1999), Informal Value Transfer Systems and Systems and Criminal Organisations: A Study into So-called Underground Banking Networks, Dutch Ministry of Justice.

\(^{12}\) Nikos Passas (2003), Informal Value Transfer Systems, Terrorism and Money Laundering, a report to the National Institute of Justice.
Reason for existence

In general, IVTS is based on tradition and is often connected to a certain type of ethnicity, operating in areas where formal banking is poorly developed. Contrary to what many believe, many IVTSs are now regulated and must abide by the reporting requirements, register with FinCEN and be licensed in the states they operate in. They must file suspicious activity reports (SAR). However, it is the unregulated providers, those that are not registered and/or licensed, that are mostly exposed to be used to move funds for terrorist financing and other illicit purposes.

In some jurisdictions, IVTS is the only method through which families can send and receive funds from their families that live abroad. IVTS predates the traditional banking system. In fact, it was used as a method to settle accounts and to move funds between villages and rural areas. Nowadays, not only immigrants but also businesses use IVTS to conduct transactions in countries with no or weak formal financial system.

There are various reasons why those living and working in a foreign country seek to use this method over the commodities of western banking. Some of these reasons are:

- Political instability, inadequate payment systems, and/or an unstable financial sector that exist within a country;
- Lack of easily accessible formal financial institutions in remote areas of some countries;
- High foreign exchange rates;
- Conversation rate is lower than the fee at a financial institution;
- Faster; and
- Alleged anonymity.

These advantages are not only attractive for migrants but also for criminals seeking either to launder their illegally obtained funds but also terrorist financiers. Still, it will make it more difficult to distinguish between the funds for terrorist financing and funds destined for families. Jamaica has a flourishing underground economy/banking system. This is because of the stringent government restrictions, slow licensing process, high tariffs and other prohibitions that provided a fertile ground for the growth of informal remittance systems.

In some instances, IVTS operate visibly in the open or are provided as an additional service from otherwise legitimate businesses, such as:

- Jewelers
- Car rental
- Grocery stores/ deli
- Travel agency
- Money exchange houses
- Phone shops
- Import, export/ shipping

The business owners/operators are in general well-known individuals and/or come from a well-respected business family in an ethnic community. Although hawala is the center of this paper, it is not the only remittance system through which large funds can be transferred and that is vulnerable to abuse.
Categories of IVTS

IVTS can be divided into two categories, Informal Fund Transfer Systems (IFTS) and Informal Value Transfer Mechanisms (IVTM). IFTS and IVTM can be seen at times as two separate systems, yet there are transactions that are common to both systems.

IFTS refers to a financial system in the absence of, or parallel to conventional banking channels. The focus lies on transfers of funds and consists of the traditional remittance systems such as hawala, hundi, black markets for currency exchange and physical currency transfer or value. The customer base of IFTS consists mainly of legitimate users, funds for family support to the family of expatriate workers and payment for goods. However, it may also consist of proceeds of crime and terrorist purposes. The system is run by an operator that provides the service to his customer via informal channels.

IVTM is the contrary. IVTM refers to a specific method for the transfer of both funds and value that may be used by individuals, networks and organizations. It is used to avoid detection of personal monetary or value transfers. The transfers occur via informal channels or modern sophisticated technologies. While the funds flowing through IFTS may be mostly from immigrant workers, the funds and values flowing through IVTM are rarely from immigrant workers. In comparison to IFTS, IVTM consists of transactions of a complicated nature and higher value transfers than the average immigrant worker transactions. IVTM can transfer a greater amount of funds than IFTS. This means that bad actors will easily choose IVTM over IFTS.

Financial services and products that can be regarded as IVTM:

- In-kind payments;
- Gifts services;
- Invoice manipulation;
- Trade diversion;
- Internet-based payments;
- Stored value;
- Credit and debit cards used by multiple persons;
- Correspondent bank accounts; and
- Options/future trading.

Caution must be exercised to not consider IFTS and IVTS as two separate systems that cannot be used at the same time. Many cases imply that transactions are based on the traditional aspects of IFTS and at the same time have the aspects of the modern type IVTM. There is no exact information or estimates of the total amounts of cash that flows through unofficial channels. International Monetary Fund estimates that the total amount of funds flowing through unofficial channels may be 50% higher than the cash flowing through official channels.

The advantages for using IVTS, poses a greater problem, as it is open to move funds from corruption, drug trafficking, human trafficking, proliferation of weapons of mass destruction and terrorist financing. Considering these facts and the magnitude of the risks involved, jurisdictions and law enforcement should be aware of the nature of these systems to deal with them properly.

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Retrieved on March 13, 2018
14 Nikos Passas (2003), Informal Value Transfer Systems, Terrorism and Money Laundering, a report to the National Institute of Justice.
Hawala

After the events of 9/11, Hawala has become a topic of discussion in the news and the political arena as an important channel through which terrorists had been able to finance their acts.

Hawala is an Arabic term for a type of informal value transfer system that means “to change” or “to transform”. The precise origin of hawala is still a topic of discussion. Scholars place its origin centuries ago in Asia, and agree that it is an old practice predating paper money and traditional banking system in the Asian/Indian sub-continent.

This method of transferring funds or value, facilitated trade and helped mitigate the risks that accompany physical transportation of value goods and money, making merchants less vulnerable to robbery on the Silk Road.  

Growing Concern

Until 9/11, hawala became associated more and more with money laundering and was often referred as some type of “underground banking”. After 9/11, Hawala then became associated with terrorist financing. The attacks of 9/11 have been financed by means of credit cards and wire transfers, but the 9/11 Commission’s report states that Bin Laden may have relied on a trusted network of hawala to move his funds effectively in the areas he operated in.

Throughout the years, a perspective has been created that Hawala is a mysterious financial system that is both dangerous and beyond ordinary analysis. Many jurisdictions consider Hawala and similar remittance systems as essential service providers to the unbanked in areas with limited/unreliable financial system. Law enforcement in several jurisdictions, see Hawala as one of the leading channels for terrorist financing and money laundering. It has become a growing concern, since in some jurisdictions a nexus has been established with the increase in crime rates and the illicit use of Hawala. Moreover, developing countries have voiced their concerns on the loss of tax revenue, foreign currency, invoice manipulation, destabilizing the local economy and increasing bribery and fraud.

Despite the fact of the amount of papers and research on Hawala, published by organizations such as FATF, IMF, FinCEN and renown scholars, BSA/AML professional still possess limited understanding of the concept IVTS. Especially of hawala. Secondly, hawala networks themselves often involve multiple intermediaries each of whom employs different methods and financial facilities, making the transactions complex and difficult to comprehend. Consequently, law enforcement is presented with several challenges while conducting financial crime investigations.

Terminology

While conducting research on this topic, the writer noticed differences of opinion amongst scholars with regards to the terminology of hawala. The perspective of these experts is similar yet different, especially when choosing the appropriate terminology. This is seen in the current literature on this matter.

This is a clear indication that the concept of hawala is of a difficult nature, to analyze, understand and afterwards regulate. Throughout the years, hawala has acquired several names. It has been referenced as alternative banking, a type of underground banking.
However, the writer chooses to refer to hawala as a type of “Informal Value Transfer System”\textsuperscript{18}. This term illustrates that hawala transactions circumvent the formal accounting procedures of national governments and international institutions rather than mystifying the system.

The term of alternative banking is not favored, since there was no other means of banking at the time of its development. In other jurisdictions, underground banking is a collective name of remittance systems such as chop shop banking, hawala, hundi and fei ch’ien. Such remittance systems are underground and banking is not always involved. In many cases, the hawaladars promote their services in the open, meaning that the service is not underground.

**Attributes of Hawala**

Some attributes of hawala are:

- It operates in areas with high numbers of expatriates/migrant workers of a specific ethnic group;
- The flow of funds consists mainly of legitimate funds, but may also consist of illicit funds;
- The hawaladar (hawala operator) is known, visible and accessible to the customers;
- The remittance service is a side business; and
- Communication between the hawaladar and the customer is limited to only what is needed to conduct the transaction.

Reasons for preferring hawala in this modern era:

- Convenient exchange rates;
- Lack of easily accessible traditional financial institutions in remote areas;
- Delays in official sector; and
- Method to move funds derived from criminal activity, terrorist financing and tax evasion.

Even though there are economic and cultural factors to explain the attractiveness of Hawala, the most important reason for one to acquire this service, is its quality, efficiency and reliability. It is important to highlight the fact that not all sources of funds of hawala transactions are to be linked with criminal proceeds. A majority of hawala activity is of legitimate purposes, such as family support.

The analysis of the preference for hawala services differs in the available literature. Some agree that it is for the anonymity, efficiency and costs. Others argue that hawala is used by those who have political reasons to do so, and those that are illiterate.

**Outdated assumptions of hawala**

**Underground banking**

Scholars often refer to hawala as a version of underground banking. This is in part accurate. It should be mentioned that hawala services are often in the open with complete legitimacy, and they are widely advertised in the media.

The below advertisement is very common in the newspapers\textsuperscript{19}:

\begin{quote}
\begin{flushright}
\textsuperscript{18} Nikos Passas (1999), Informal Value Transfer Systems and Systems and Criminal Organisations: A Study into So-called Underground Banking Networks, Dutch Ministry of Justice. \\
\end{flushright}
\end{quote}
By the term underground banking, reference is most frequently made to unregulated methods of transferring money or value from place to place. Throughout the years a perception of hawaladars has developed as shadowy figures, yet reality indicates the contrary. Hawaladars are often relatively respected individuals within their community.

**Solemnly based on trust**

Defining hawala as a trust based remittance system is often a topic of discussion between scholars. To conduct hawala transactions a trust relationship between the customer and the hawala dar is of crucial importance. Trust is also the foundation of the business relationship between the two hawaladars, without the trust it is difficult to secure the cross-border transaction(s). In most instances, hawala transactions consists of several currencies. Hawaladars are part of an extended community, and it is rare for them to defraud one another or their customer. In the rare cases where this has happened, other hawaladars have been known to make good on the debts of their colleague. While it is possible that some sort of “disciplinary action” may be taken, a hawala dar who commits fraud is one who cannot be trusted. Without the trust of other hawaladars, he can no longer function effectively.

Hawala is not only trust based but also reputation based. A hawala dar is often selected based on the reputation he holds in the community. The reputation quickly fades when a mistake is committed, leading to loss of clientele and eventually being pushed out of the market.

**Remittance system as core business**

Hawaladars do not solemnly focus on remittance services. In many cases, the main business activity may be a (mobile) pawn shop, grocery store, nail salons, flower shops, travel agency, ice cream shop, cafeteria/deli. These types of business generate income that can be easily mixed with, but also creates a perfect cover to freely offer additional financial services without falling under the radar of the government and law enforcement. The additional financial services consist of currency exchange, short term lending, trade guarantee and safe keeping of funds. Some hawaladars also provide service as import and export businesses, which enables value settlement. By having a main business and providing financial services on the side, they can easily mix the two incomes and use the customer identity documents derived from the legal business to generate records which are used to obscure the true source of funds of the criminally derived cash.

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20 FATF (2013), The Role of Hawala and other Similar Service Providers in ML/TF, FATF, Paris
Retrieved on December 13, 2017
No record keeping

A common misconception is that hawaladars keep a big book, in which they scramble codes and symbols to administer the transactions. Several investigations proved that hawaladars maintained detailed records either in soft copy or hard copy. They maintain manual accounts, ledgers, computerized records or a combination of these mechanisms.

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Figure 3. Source: Google Images. Example of Hawala Ledger.

The hawaladar

Most hawaladars operate a small business in addition to money or value transfer. The business of hawala is a means to acquire additional income. Network plays a vital role in the hawala system. Hawaladars that do business with several other hawaladars can obtain much greater profit than those with a smaller network. Hawaladars that operate in a bigger market, attract more customers, and can also be approached by the hawaladars that do not possess the necessary network to conduct a transaction.

The relationship between the hawaladars is reputation and trust based. Those who betray the trust of the system know that they and all their immediate family members must face social and commercial boycott.

Not all hawaladars register with FinCEN and become a licensed money services business. A hawaladar may happen to be someone with a day job/business, who happens to have some overseas connection, performing hawala services as a favor to friends and relatives while earning a few extra dollars on the side.

The profit of the hawaladar originates from the currency exchange manipulation. When a transaction consists of smuggling of gold, the profit will lie in the sale of the gold and not very much in the remittance service. There is no need for documentation and there exists a minimal need for accounting, which makes this service more attractive.

How it works

In the ancient times, merchants would send funds to their homeland by depositing the funds with a hawaladar who normally owns a trading business. For a small fee, the hawaladar would arrange for the funds to be made available for withdrawal from another hawaladar, normally also a trader, in another country. The two hawaladars would settle accounts through the normal process of trade.

Today, the process works the same way. Hawaladar A, on one side of the transaction accepts money from a client who wishes to send funds to someone else. Hawaladar A, then communicates with Hawaladar B, at the desired destination who distributes the funds to the intended recipient (less small commissions at both ends).
The money does not physically move from Point A to Point B. Most brokers are of the same ethnic group and many are members of the same family, tribe, or clan. As John Wilson stated, the funds go through informal channels and may not go through banking channels until later in the process.21

Transaction examples

The basic components of a transaction are:

1. Originator/sender;
2. Beneficiary/receiver;
3. The funds;
4. Transaction code; and
5. Two hawaladars.

There is no physical movement of the funds. However, the funds are “moved” by means of a code. Without the code there is no transaction. To illustrate the above components, analyze the following example.

Arif lives and work in New York. His family is back home in Pakistan. His wife called him and mentioned that his son is sick and requires urgent medical attention. The cost for this treatment is Rs15,000 ($235.05) and she needs the cash the next morning. Arif doesn’t have a bank account in the US yet and his wife does not have a bank account back home. Samja tells Arif of Hameed. Hameed is an esteemed member of the Pakistani community in New York, and is the owner of Punjabi Clothing Store. Next to his clothing store, he also provides the service to send money back to Pakistan. Arif provides Hameed the $235. Hameed calls Basim and provides him with transaction details. Basim proceeds to arrange to deliver the funds to Samia, wife of Arif, on the next day.

A transaction code can be among other things, a code, an excerpt of the Koran, or a serial number of a bank note. As seen in above example, no physical money traveled between the two destinations, when the transfer was requested. Instead one hawaladar came into the debt of one other, using funds already available in the beneficiary country. This is a simple transaction which demonstrates the key factors of a transaction, the social connection trust and reputation.

Settlements

While providing service to their customers, hawaladars will have to settle accounts with their partners. Such settlement will not occur on a one-to-one basis but are accumulated after several transactions. Small balances are settled at a higher level of hawala, with other operators.\(^2\)

Cash based societies are exposed to the physical cash currency transport. Periodically, hawaladars settle the accounts by use of hawala cash couriers to transport the cash from one end to the other. There is indication that some hawala networks included virtual currencies in their methods to settle the debts.

Hawaladars can also use trade to settle accounts, by simply paying with goods instead of actual cash. For example, hawaladar A may send goods/values, such as, gold, mobile phones or cars may be purchased by hawaladar B to send to hawaladar A. Hawaladar A on its turn, will sell them for profit. Invoice manipulation is widely used.

The following exemplifies this fact: There are two hawaladars that have a business relationship and have a hawala debt from both sides. hawaladar A, by under invoicing a shipment of herbs and spices to hawaladar B. A could have sent B a shipment worth $1500 but only charge him $900. The difference of $600 is used to settle the debt between the two hawaladars. The process could also be done in reverse. hawaladar A can send an invoice for an amount of $1500 but charge him $2500. When the payment is done $1000 enters the US covertly. In many cases, the families of the originator, rely on the received funds to pay for medicine, food and housing expenses. Larger amounts may refer to payments for weddings or funerals.

Balances may be settled through financial instruments such as bearer instruments and checks. Formal financial channels are also used to settle the debts, via wire transfers to the recipients foreign account. In cases of a simple transaction, both ends may choose to use the bank accounts. Most settlements go through so called hub locations, UAE, London, Tokyo, New York and some European countries. Settlements may also take place through payments to third parties around the world.

Red flags

When monitoring accounts for hawala related transactions, financial institutions may apply red flags applicable for money laundering, terrorist financing and trade based money laundering (TBML).

This chapter aims to provide guidance on red flags on transactions patterns that are often associated with unlicensed IVTS service providers, including hawala service providers. The key to identify said transaction are to implement an effective transaction monitoring system and apply proper KYC. Financial institution must conduct further investigation can detecting two or more of the red flags.

Such red flags include:

- Hawala bank accounts reflect a significant deposit activity, in forms of cash and checks. These checks may be from someone associated with the account
- In some cases, the beneficiary countries of these transactions are countries that are known for hawala
- Accounts are credited by businesses that do not have an apparent link with the other business
- Different bookkeeping methods for customers

- Large transactions are not recorded
- Large volumes of transactions are received from one customer
- High turnover in account of low income earner
- Bulk cash shipments
- Cash couriers travelling to jurisdictions known for hawala
- Physical movements of cash daily
- Transfer to businesses that have no apparent connection with the originating party
- Transactions that have no commercial or economic sense for a personal/business account
- Fluctuations in commission rates/fees for the customers
- Grocery stores that have a high amount of physical cash

**Hawala- Legal or Illegal?**

The discussion of whether hawala is legal/illegal, is a long-standing discussion between scholars, law enforcement and regulating entities. Not all countries have regulated hawala. The result is that hawala remains illegal in several countries around the world. Yet, not all hawala customers are using this remittance system for unlawful purposes. As the system has many advantages, it poses an opportunity for money launderers and terrorism financiers.

Hawala is subject to regulations as money remittance services in several countries.

**United States of America (USA)**\(^{23}\)

In the USA, IVTS service providers are classified as money services businesses (MSBs) and should report to FinCEN. This means that they must comply with recordkeeping, reporting, and anti-money laundering (AML) program requirements under the BSA.

As a result, hawala and similar remittance systems are legal, if the operation is registered with FinCEN\(^ {24}\) and meets individual state licensing requirements. Despite the countries effort, a majority of MSBs operate without direct Federal regulatory supervision.

Nonetheless, some countries consider hawala as illegal from a regulatory perspective, although enforcement is difficult as such services are usually advertised in ethnic media or via internet in dialects. Hawala brokers often run legitimate businesses and provide the remittance, which further challenges potential detection.

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Hawala and Terrorist Financing

Financial crime investigations conducted recently report that:

• ISIL uses hawala networks in Syria and Iraq
• Hawala is used in Europe to support terrorist groups
• Hawala was used to fund the 2015 Paris attacks (This attack killed 130 people and injured 813 people.)

While terrorist groups may support themselves with funding from illicit and legitimate sources, they “process” these funds – that is, move them from the source to their destination – in much the same way that criminal groups launder their funds. There exists an undeniable nexus between hawala and terrorist financing. This type of remittance system is attractive to terrorist financiers because primarily it is not subject to regulatory oversight and KYC and reporting measures.

Hawladars are not subject to the same record retention measures as formal financial institutions. Even though they do maintain ledgers, no significant information can be deduced when conducting financial crime investigation. Some hawladars conduct hawala transactions when aware that the source of the funds is from illicit proceeds, specifically for terrorist activities. Such hawladars are profiting from the existence of ISIL. Hawala proved to be an effective method to hide the origin and destination and break the audit trail of money.

Media reports and studies indicate that hawala networks are used in areas which terrorists are heavily active, even mention that hawala is a central component in the economy of Libya. ISIL networks use hawala to move funds from Syria and Iraq to the ISIL wing located in Libya. Boko Haram is known to receive local and international donations via cash couriers and hawala transactions. The origin from these funds are from jurisdictions from the Middle East, Saudi Arabia and United Kingdom.

Law enforcement managed to arrest a cash courier that was travelling between Niger and Chad on a frequent basis.

The presented information, clearly indicates that even though there are AML/CTF measures in place for the traditional banking system, which limits them to be accessed by terrorist groups, they still manage to move the received funds around by informal channels, specifically Hawala. Even though there are several

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Retrieved on January 31, 2018

Retrieved on January 31, 2018
other IVTS, hawala is chosen because of its global scope. Together with fei-chien, they are methods to launder and move billions of unregulated cash every year.\textsuperscript{27}

Law enforcement in India and Pakistan confirm, that one of the preferred methods for moving funds among the terrorist groups is hawala. Investigations also point towards a hawala ledger containing hawala transactions that may have been used to finance bombings at US African embassies.

It should be noted that hawala transactions destined for terrorism purposes may be originated from legitimate or illicit purposes. A financial crimes investigation proved that the Taliban used regulated banking systems to launder illegal funds but apparently turned to the use of informal remittance systems IVTS after the implementation of more stringent Afghan banking rules. A FATF report\textsuperscript{28} for the West Africa the TF in West Africa report highlights the use of MVTS to provide funds to recruit foreign terrorist fighters (FTFs) and aid their travel to conflict zones.

Secretary General Ban Ki-moon\textsuperscript{29} addressed the importance of combating terrorist financing in a 2015 United Nations Security Council meeting. He indicated, that “Terrorists take advantage of weaknesses in financial and regulatory regimes to raise funds. They circumvent formal channels to avoid detection, and exploit new technologies and tools to transfer resources. They have forged destructive and very profitable links with drug and criminal syndicates — among others. And they abuse charitable causes to trick individuals to contribute”. The United Nation Secretary General explained that terrorists continue to adapt their tactics and diversify their funding sources. These funding sources include raising funds through the oil trade, extortion, undetected cash couriers, kidnapping for ransom, trafficking of humans and arms, and racketeering.

\textbf{Case Study}

\begin{quote}
In a case of hawala money transfer to terrorists of the proscribed terrorist organization “X” in India, two hawala operators along with two receivers of hawala money for the terrorists were apprehended in the year 2011 and an amount of approximately INR 2 000 000 (USD 32 000) was recovered from them. They revealed that the hawala money was provided by the organization leaders based in country “Y” and routed through another country “Z” where another over ground worker of the terrorist organization is based. The modus operandi is that the terrorist leader in country “Y” collects terror funds in that country and sends it to another terrorist agent in country “Z” who contacts hawala operators who operate freely in that country.
\end{quote}

\footnotesize


Red flags

Financial institutions must understand that hawala operators, operate a legitimate business. Even though the businesses are small (e.g. deli/ phone shop), their bank account may have a turnover that is not commensurate with what one would expect for a business of its size and type. When such scenarios are detected, a red flag should be triggered with the BSA/AML officer. This could be an indication that the transaction may be connected to either laundering of criminal funds or terrorist financing. Financial investigation should be conducted to determine the nature of the transactions.

Certain non-profit organizations (NPOs) that disburse funds or aid in some developing countries use IMVT systems to send the funds to remote locations or to areas that are not adequately served by traditional financial institutions. Throughout investigations, law enforcement authorities discovered that an NPO’s headquarters was in the same office as an IMVT, which had already been linked to money laundering operations. The authorities in three other FATF member countries have observed the trend that certain IMVT services are avoiding new requirements to register or obtain a license by re-establishing themselves as NPOs. By avoiding registration as a money remitter, the supposed NPOs could then theoretically continue to remit money without having to submit to the oversight of the financial regulatory agency.

Hawala and Money Laundering

Investigations conducted on both IVTS and hawala, established the nexus between money laundering, IVTS, and hawala. Thus, hawala can be incorporated throughout the stages of money laundering. Hawala proved to be highly effective in the placement stage. How is this possible?

The customer provides the hawaladar with the cash. Afterwards the hawaladar deposits the received amount into a bank account (placement). Whilst completing the source of funds, the hawaladar will argue that the source of the deposited cash is legitimate business proceeds of the business he conducts. However, he will not deposit all the cash into his bank accounts but will use the remaining funds for operational costs/business expenses. As mentioned earlier in this paper, hawaladars are legitimate business owners. In many cases, these businesses serve as a front for the financial services that are being

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provided. The funds originated from these activities will be commingled with the revenue of the businesses.\textsuperscript{31}

When the funds are in the bank accounts, the layering process will commence by transferring the funds from one account to another. To make this more complex, the funds can be transferred to hawaladars from different jurisdictions. A basic hawala transfer in this case will leave little or no paper trail. As for the layering stage, the funds will be processed as to appear legitimate. Money launderers use the same approach throughout the laundering schemes the funds are transferred to other accounts. Wire transfers can also occur between several jurisdictions and parties. In the third and final stage, which is integration, the funds will be used for various purposes such as investment in assets. There exists a high probability that the funds will re-enter the economy as an investment in the front business.

**The Netherlands**

Underground banking has been active for quite some time in The Netherlands in the year of 2005. In 2012, the public prosecutor’s office of Amsterdam seized between May 2010 through May 2012, eight million euros. During that time laundromats, grocery store or phone shops have been used as money remittance businesses. Law enforcement investigation proved that drug transactions were conducted in these businesses.\textsuperscript{32}

**Case Study**

**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 throughout the world through the use of wire transfer payments.


**Challenges**

**Challenges: Global Scale**

1. **Achieve a balance in supervision and regulation**

The process to find a balance between proper supervision and regulation for Hawala, is a challenge for authorities. The real challenge comes forth from the mitigation of the risks of unlicensed hawala service provider poses for jurisdictions.

2. **Decrease the amount of unlicensed hawala service providers**

Hawaladars may be open to cooperate with financial crime investigations. This does not necessarily mean that they will willingly register or apply for a license as required by BSA (or the equivalent law in other jurisdictions). Nor will they be aware of the legal basis of such provision. A stringent regulatory climate


**Genesis J. Martis**
will have as consequence that hawaldars may avoid these traditional banking systems altogether or will not generate sufficient activity to arouse suspicion of banking officials, then no reports will be filed. In addition, it will further move this remittance system to the informal spectrum or the legitimate user will suffer the consequences.

3. Detection of the transactions

Hawaldars maintain records of the conducted transactions, to keep score of the debt they have with their business partner. The record keeping is elemental for the settlement of the accounts. However, the ledgers may not be always legible or comprehensive for a third party. Law enforcement must than rely upon the reporting (SAR’s and CTR) of financial institutions to conduct investigation and detect the transactions.

Despite the challenges, jurisdictions must undertake certain steps to mitigate them. If no effort is being made, it will make hawala service providers more vulnerable for abuse by criminals and terrorist financiers.

Challenges: Country of Curaçao

The country of Curaçao has recently increased its efforts to undermine the underground banking sector/informal economy on the island. During an interview, the public prosecutor Bos, suggested that a change in mindset within law enforcement and the public prosecutor’s office should be achieved. The flow of money should be cut. Drug traffickers cannot purchase the drugs without cash. No cash, no drugs. The same strategy can be applied for terrorist financing.

Furthermore, the prosecutor developed a new strategy to capture those involved in drug trafficking, when arrangements are being made to pick up funds to pay for the drugs. This strategy has proven to be successful both in cases in the Netherlands33 and in Curaçao34.

Underground banking is an issue of concern on the island. The 2017 International Narcotics Control Strategy Report, mentions that the Country of Curaçao should investigate underground banking networks. The common front businesses for underground banking on the island, are the Chinese grocery stores. In the Netherlands, common front businesses are the laundromats, phone shops and ethnic grocery stores. The procedure to apprehend cash couriers is a costly one for law enforcement. The observance phase requires time and requires a flexible budget.

Recommendations

Financial institutions, law enforcement and AML compliance officers are encouraged to make efforts to conduct proper KYC. Getting to understand how hawala (and IVTS) operates is essential to distinguish between illicit and legitimate funds. The more knowledge is acquired, the easier it becomes to find ways to legitimize this remittance system without affecting the legitimate users. Analyzing the above information, we can conclude that if a country has a more lenient regulatory climate, the financial system and its products are prone to be exploited for terrorist financing.

There is a growing nexus between terrorist financiers and the abuse of hawala. There exists a similar yet different perspective on hawala amongst scholars, making it difficult at times to mitigate the risks of being used in terrorist financing. The fact that hawala circumvents AML/CTF measures to facilitate both legitimate and illegal funds, makes it more difficult to detect the funds linked to terrorist financing.


Terrorist leaders clearly indicated that there are cracks in the modern financial system. IVTS is surely one of the biggest cracks.

How can jurisdictions lessen these cracks?

**Global Scale:**
- Law enforcement in jurisdictions should focus on raising awareness within the private sector of hawala & IVTS;
- Jurisdictions should strengthen the communication and cooperation between the public and private sector;
- When sufficient knowledge is acquired, jurisdictions should conduct research on the vulnerabilities of these remittances;
- Jurisdictions should keep on strengthening their efforts to comply with the FATF 40 Recommendations and Special Recommendations on Terrorist Financing in relation to remitters;
- Jurisdictions should implement and assign independent supervisory authorities to monitor and enforce the application of these recommendations, and provide guidance to hawala service providers;
- Jurisdictions should develop effective regulations (assess if current regulations are effective) by keeping in mind the nature of hawala;
- Jurisdictions should create an international platform (mutual legal assistance) in which assistance can be provided to jurisdictions that lack the skills or funds to curtail illegal hawala service providers;
- Develop agreements between law enforcement agencies to share information and knowledge to allow for the exchange of information among law enforcement agencies;
- Jurisdictions should be able to impose sanctions on money/value transfer services, including informal systems networks that fail to obtain a license/register and fail to comply with relevant FATF recommendations;
- In countries where an informal hawala system exists alongside a well-functioning formal sector, it is recommended that hawala dealers be registered and keep adequate records in line with the FAFT recommendations;
- Study the nexus of virtual currencies and hawala;
- Develop statistics and trends submitted at the respective financial intelligence units or similar agencies.

**Regional Scale**

In regions where the flow of cash is processed, mostly through informal remittance systems, a balance must be reached between supervision and regulation. For instance, countries which have stringent controls to convert foreign currencies may conduct a national risk assessment to discover ways to mitigate the risks for the conversion of currencies. Upon the mitigation of such risks, these jurisdictions can develop alternative and supervised channels to convert foreign currencies.

It is strongly advised that such jurisdictions, specifically in the Asian part of the world, join efforts to detect unlicensed remittance systems and share criminal investigation information where permitted. It is also advised that best practices be shared. Jurisdictions are recommended to develop central registered kept by the respective Central Banks.

Develop an educational program to raise awareness of the abuse for money laundering and terrorist financing amongst hawala service providers and other similar remittance systems. Supervisory entities and financial intelligence units can collaborate and promote compliance to applicable (AML) compliance laws and regulations.
Furthermore, regulation of hawala services can be achieved as with the case of the US. Jurisdictions are also recommended to conduct strategic studies on hawala, hundi and fei-chin. Such studies will indicate the impact on the jurisdiction and advise the additional regulations.

Local Scale: Curacao

- Law enforcement of Curacao should focus on intercepting drug dealers with (large) cash amounts destined to pay for drugs and weapons;
- The country of Curacao should conduct investigations of underground banking networks\(^{35}\);
- The country of Curacao should raise awareness among public prosecutors to understand the nature of hawala service providers and detect underground banking, to increase the prosecution in this area;
- The country of Curacao should focus on strengthening the cooperation between the judicial branch, regulators, the financial intelligence unit and the private sector;
- The financial sector should acquire more knowledge of operation of terrorist organizations, how they acquire funds and move same around to fund the organization and or cells;
- The financial sector must increase awareness of red flags for hawala service providers and underground banking within their institutions;
- Law enforcement and the private sector must implement a platform to exchange information to implement CTF measures effectively.\(^{36}\)

Conclusion

Hawala in general is used to move funds for legitimate purposes. However, the biggest risks lie in the unlicensed hawala service providers. Due to its many advantages, hawala is vulnerable to abuse from terrorism financiers. There is undoubtedly a nexus between hawala and terrorist financing. The remittance system moves funds from legitimate sources, aiding the individuals in remote areas to receive funds to provide for their families or pay for goods. Nonetheless, remittance systems like hawala do not possess the necessary AML/CTF controls to mitigate the risks to be used as a conduit for terrorist financing and money laundering.

For this reason, it is important that financial institutions invest in training for the BSA/AML personnel to ensure that they have proper understanding of how IVTS works, especially hawala and how to recognize this. Without proper training, BSA/AML officers will not be able to capture such transactions. Thus, training on this area should be the incorporated in the AML Training program of financial institutions. Law enforcements are also encouraged to invest in training on how to spot (unlicensed) hawala service providers. Efforts to study IVTS and how it affects the community is also encouraged. Jurisdictions are encouraged to examine the suggestions provided in this paper to minimalize their exposure to the risks of the nexus between hawala and terrorist financing.

https://www.state.gov/documents/organization/268024.pdf