HM Treasury Review of

The Regulation of Money Service Businesses

A response from Dr. Roger Ballard,

Director,

Centre for Applied South Asian Studies,

University of Manchester

8th December 2006

TABLE OF CONTENTS

1 MY INTEREST IN THESE MATTERS 1
1.1 Academic history 1
1.2 Transnational networks 1
1.3 My activities as a Consultant anthropologist 1
1.4 Analysis and Publication 2
2 IMMEDIATE ISSUES OF CONCERN WITH RESPECT TO THE REGULATION OF MSBS 3
2.1 Regulation and its objectives 3
2.2 My personal focus: the operation of IVTS/Hawala style Value Transmission businesses 4
2.3 Lining up vocabulary: my own terminology and that deployed in the review document 5
2.4 Regulation and inspection 7
2.5 Consolidation, settlement and deconsolidation in the informal sector 8
2.6 'Informality' 9
2.7 The monitoring and regulation of 'informal' value flows 10
2.8 Risk and Regulation 11
3 LAW ENFORCEMENT EFFORTS TO IMPLEMENT AML/CFT: SUCCESS OR CHARADE? 12
3.1 Prosecution strategies 12
3.2 The pursuit of terrorists in the United States. 13
3.3 The pursuit of money launderers in the UK 14
3.4 The reaction of IVTS/Hawala operators to the new regulatory regime 16
3.5 Cash settlements and their vulnerability 17
3.6 Why implement settlements by cash transfers rather than by bank transfer 18
3.7 Catch 22 18
3.8 Regulatory uncertainties as a source of risk 19
4 THE REGULATORY CHALLENGE 22
4.1 The challenge 22
4.2 Current regulatory priorities 22
4.3 A comparison with experience in the United States 23
4.4 A regulatory approach which leaks like a colander 24
4.5 Stopping the loophole 25
5 CONCLUSION: SOME REALISTIC SUGGESTIONS FOR THE BETTER REGULATION OF IVTS/HAWALA MSBS 28
5.1 Recognise reality 29
5.2 Seek the cooperation of those whose businesses are to be regulated 29
5.3 Improve communication 30
5.4 Refine the objectives of regulatory activity 31
5.5 Fighting terror with error? 33
APPENDIX 1: ROGER BALLARD CV 36
APPENDIX 2: EVIDENCE GIVEN TO THE SELECT COMMITTEE ON INTERNATIONAL DEVELOPMENT 38
APPENDIX 3: "Coalitions of Reciprocity and the Maintenance of Financial Integrity within Informal Value Transmission Systems" in *Journal of Banking Regulation* Volume 6, no. 4
APPENDIX 4: 2006 "Hawala" in *Newsletter of the International Institute for Asian Studies*,

The Challenge of Regulating IVTS/Hawala value transmission networks

1 My interest in these matters

1.1 Academic history

During the course of the past thirty years my principal area of academic interest has been in the social, economic, cultural, political and religious consequences of mass migration from Northern India and Pakistan to the UK. As an anthropologist, my central focus has been on the qualitative characteristics of these developments, with the result that I have taken a close interest, amongst other things, in the transnational networks which South Asian migrants developed to facilitate their entry in the UK, to establish ethnic colonies around themselves following their arrival to facilitate the processes of settlement, and last but not least to facilitate on-going contact with their kinsfolk back home. I have published numerous academic papers exploring both the structure and the consequences of these developments. (See my CV in see appendix 1),

1.2 Transnational networks

Although I had long been aware of the Hawala networks which many migrants utilised to send their savings home, my specific interest in MSBs arose as a result of my participation in the Economic and Social Research Council's Transnational Communities Programme, within the context of which I carried a project on *Kinship, Entrepreneurship and the Transnational Circulation of Assets*. This project focussed on the circulation of persons, ideas, and financial assets through the transnational networks established by Jullunduri (Indian), Mirpuri (Pakistani) and Sylheti (Bangladeshi) settlers in the UK. Whilst funding from the ESRC only lasted for two years (1999 – 2001), I continued my research in this field thereafter thanks to further support from the University of Manchester, the Department for International Development, and most recently from my own personal resources.

1.3 My activities as a Consultant anthropologist

On the basis of my academic work in this field I was engaged to act as an expert witness for the defence in the course of prosecutions which HM Customs and Excise (as it then was) had brought against three substantial MSBs in West Yorkshire engaged in making value transfers

to Pakistan. As a result of being appointed as an expert witness I gained access to a veritable treasure trove of data: the records, bank statements and so forth which Customs and Excise had seized from the defendants, and which the prosecution used as the foundation of their case against them. Hence all this material was also released to the defence – and on to me in my role as an expert witness.

My role as an expert in these circumstances was to subject the case put forward by Customs and Excise to critical scrutiny, which I did. However I should also stress that my role as an expert was not simply to act as a 'hired gun' for the defence. Rather as the law requires, I took it for granted that my central duty was to the court, rather than those instructing me. Hence my central task was to offer my objective opinion as to the significance of the evidence laid before me in the light of my specialist academic knowledge, and on that basis to subject the interpretation of its significance put forward by the prosecution to critical scrutiny. In the course of so doing I came to conclusions which differed substantially from those drawn by Customs and Excise with respect to the evidence in all three of the cases in which I was initially instructed. I have remained similarly critical of the analyses advanced by Customs and Excise in virtually all the subsequent 'hawala' cases in which I have been subsequently instructed to act as an expert.

1.4 Analysis and Publication

In the course of being so instructed, I gained access to the records get by the hawaladars in around ten hawala operations of differing shapes and sizes – and hence to large volumes of empirical data about the day-to-day operation of contemporary value-transmission networks of this kind. As a result of my ever-growing knowledge of the operation of such networks I have been invited to give presentations on how the system works at The Centre for the Study of Financial Innovation (City of London), at the second International Conference on Hawala in Abu Dhabi, and for the C.I.A. in Washington D.C. As a result of so doing I have had the opportunity to discuss the issues with to numerous IVTS/hawala operators at a wide range of levels in the business, with senior officers from both Central and Commercial banks operating both in the UK and in the Indian Ocean region, with economic specialists from the World Bank and the IMF, and with fellow academics with an interest in these matters based both in the UK and the USA.

Having begun by circulating a number of reports, working papers and PowerPoint presentations on the subject, I moved on to set out my observations and conclusions in print, in papers entitled *Delivering Migrant Remittances: the logistical challenge*,[1] *Coalitions of Reciprocity and the Maintenance of Financial Integrity within Informal Value Transmission Systems: the operational dynamics of contemporary hawala networks*,[2] and rather shorter paper originally entitled "Hawala: criminal haven or vital financial network?", but which was reduced for reasons to space to the single word *Hawala*[3] by the publication's editor. Given that most of the arguments which I have set out in this response are based on analyses and conclusion which I have set out in much greater length in my published work, I have attached the last two of these papers as appendices to this response.

2 Immediate issues of concern with respect to the regulation of MSBs

2.1 Regulation and its objectives

Given that flow of value through IVTS/hawala networks probably amounts to several billion pounds per annum for the UK alone, and very much more at a global level, it is only reasonable that those responsible for processing these value transfers should – like all other actors in the financial services market – be subject to regulation. What is much less clear, however, is just what the objectives of an appropriate regulatory regime should be in this particular context. It goes without saying is only when those objectives have been clearly established that the next stage in the argument – namely how those objectives can best be achieved – can sensibly be addressed. Incidentally it is with such concerns in mind reached. I myself have already had several stabs at addressing the underlying regulatory issues, as can be seen in a proposal (see Appendix 2) which I put together in collaboration with Dr Saad Shire of Dahabshiil Transfer Services at the suggestion of the Parliamentary Select Committee on International Development.[4]

1 *Journal of Financial Transformation*, Volume 12, (2004) pages 141 - 153

2 *Journal of Banking Regulation*, Volume 6, 4 pages (2005) 319 - 352

3 *Newsletter of the International Institute for Asian Studies*, No. 42 (2006) p. 8 - 9

4 *Sixth Report of House of Commons International Development Committee, Session 2003-4* London: The Stationary Office HC-II, Ev., 157 - 167 (2004)

In view of my long-standing concerns in this area, I am delighted that the current review is now being conducted, that also that it is being undertaken with the Hampton Review's *Better Regulation Principles* firmly in mind. However in addition to those principles, I would also like to take the opportunity to flag the importance of a further caveat which should be self-evident: that to seek to construct a regulatory framework in the absence of a comprehensive understanding of the financial processes which it is designed to regulate, and without the active cooperation of those who activities are being regulated is unlikely to fulfil its desired objectives..

Having carefully read the contents of the consultation document, I am by no means convinced that either of these caveats have yet been adequately met. This response seeks at least partially to remedy some salient aspects of those deficiencies.

2.2 My personal focus: the operation of IVTS/Hawala style Value Transmission businesses

All the arguments I make and the conclusions I reach in this document have a very specific focus. To the extent that my first hand experience of the operation of IVTS/Hawala style Value transmission businesses involved in transferring value from UK-based customers to the destinations reaching in an arc from Somalia through the Middle East to South Asia, I can only speak with confidence about that sector of the value transfer market. I have good reason to suppose that operators serving other areas – especially in East and South-East Asia – may well use similar transfer methodologies. However as yet I have not been in a position where I have been able to gain access to direct evidence (by which I mean detailed financial records) which supports my belief that the same methodology is used in those spheres as well.

It is also worth noting that whilst the greater part of outward transfers currently passing through these networks can be described as migrant remittances, a small proportion of the outflow, and in all probability the greater part of inflow of value passing through the network in the reverse direction by way of settlement, are business-to-business value transfers of some kind.

It also goes without saying that at present it is impossible to produce accurate data on the scale on which value flows back and forth through such 'informal' channels. However to put some sort of scale to our discussion of the subject I would suggest that a reasonable ball-park

figure for the UK is £2 billion per annum, with a much greater prospect that the true figure is greater, rather than less than, that sum. It also goes without saying that some of these funds *may* in some sense of criminal origin, However I would go along with the consensus amongst the majority of informed commentators that that only a small (although by definition unknown) proportion of the total flow of value is tainted in this way.

2.3 Lining up vocabulary: my own terminology and that deployed in the review document

In terms of the Review document, the MSBs with whose operations I am concerned in this response would appear to congruent with those identified in paragraph 4.1:

- **Money Transmitters**: which transfer money from one location to another without physically moving the cash. The transfer is usually to an overseas location using a variety of methods including wire transfers, telephone and fax, bank transfers and offsetting liabilities. A fee is charged for the transfer and profit made on currency exchange.

However rather than using the generalised appellation Money Transmitter, I prefer to use an classificatory identifier which focuses on the specific form of settlement procedure which such Money Transmitters utilise in order to facilitate the delivery of value to the overseas destinations specified by their customers: with that in mind my own preferred term (and the term which I use in my academic publications) is an IVTS/Hawala operator – or in a word a Hawaladar.

I am by no means certain that all the 9,767 businesses which HMRC identifies as Money Transmitters actually utilise IVTS/Hawala style value transmission systems: that matter could only be decided by empirical inspection of their back-office methodologies. Moreover I am equally well aware that many businesses using utilising settlement and transmission systems of precisely the kind I have in mind, some of whom might well appear elsewhere in HMRC's categorisation of MSBs, might vigorously object to my use of the term Hawala to identify their preferred settlement methodologies.[5] However rather than invent a more innocuous

[5] At the Second International Conference on Hawala held in Abu Dhabi, a speaker on the platform asked the several-hundred strong audience to raise their hands if they actually practiced Hawala. Only one hand went up. But before concluding that the Conference was discussing business and financial practices in which none of the rest of the Conference participants were involved, I can readily testify that at least a third of the audience were engaged in much the same kind of business as Mohamed Djirdeh (the Hawaladar who raised his hand), and most of them on a very much larger scale than he.

euphemism to identify that the procedures which I have in mind, I prefer to continue to use the terms Hawala and Hawaladar, and to place both within the broader frame of those operating Informal Value Transfer Systems, or in shorthand IVTS.[6]

With such considerations in mind I would like to take the opportunity that I have used the term IVTS/Hawala in this document as a convenient (and I hope accurate) technical descriptor with *no necessary prejudicial overtones whatsoever*.

The reasons why I have raised these terminological issues right at the outset goes to the core of my concerns in this response. Remarkably enough, at no stage does the consultation document provide a detailed consideration of the way in which those businesses which it identifies as Money Transmitters actually implement the *financial* dimension of their transnational/trans-currency value transfers. The document quite rightly indicates that none of these businesses transmit currency notes overseas: like all other MSBs, Money Transmitters implement the delivery of value to recipients overseas through some kind of financial settlement process. However the document contains no discussion of exactly how this is achieved by businesses in different sectors of the value transmission market, even though the precise basis on which this is achieved is the key determinant of the cost at which and speed with which such transfers can implemented on behalf of customers.

With this in mind it is worth noting that only reference to methods used by Money Transmitters go about the business of implementing overseas value transfers to be found in the consultation document is a phrase which appears in the paragraph cited above, indicating that it can be achieved by "*wire transfers, telephone and fax, bank transfers and offsetting liabilities.*" This cannot possibly be described as an adequate technical description of what is of necessity a complex logistical process. Worse still, the activities so identified are so generalised and so diverse as to empty the phrase of any significant meaning – at least at it stands. Nevertheless a little exegesis may help fill to fill the issues out. Considered analytically, the activities identified can conveniently be grouped into three distinct categories:

[6] The origin of the classificatory term IVTS can be traced to Nikos Passas' report *Informal Value Transfer Systems and Criminal Organizations; a study into so-called underground banking networks.* The Hague: Ministry of Justice, (1999).

i. *Telephone and fax messages*, through which information – but not value – can be transferred

ii. *Wire and bank transfers*, which can be used to transfer value as well as information, but only which also incur a substantial commission or fee. Hence the cost of transferring small sums on this basis are cripplingly large, unless a multiplicity of small sums are combined into a single consolidated tranche for which the fee is hardly any greater

iii. '*Offsetting liabilities*' is a term which does not appear at any other point in the consultation document. Nevertheless it may well be that this refers to the implementation of what I would describe as a 'back-to-back' hawala swaps.

If mode iii. is widely used as means of implementing value transfers by those businesses referred to as 'Money Transmitters' in the consultation document, it may well be – although I cannot be certain – that their operations are wholly congruent with account of IVTS/Hawala transfers which I have set out in my publications on the subject. Given that at this stage I am in no position to judge how closely the two terminologies map over one another, for clarity's I will stick to my own preferred usage in this response. I leave it to others to determine how far any given MSBs settlement procedures are congruent with the analytical models around which this response is constructed.

2.4 Regulation and inspection

Just the same issues also arise with respect to the objectives and implementation of the inspection regime devised by HM Customs and Excise, and now implemented by HM Revenue and Customs. The Consultation document certainly confirms something which I have long suspected: that current regulatory and inspection process is exclusively concerned with to Money Transmitters front-office procedures: in other words with the implementation KYC, record keeping and SAR requirements. If I understand matters aright, this is in keeping with fact that to date neither the regulations with which MSBs are required to conform, nor the office procedures which inspectors are required to examine on their periodic visits to MSBs make any specifications whatsoever with respect to the structure of 'back-office' procedures which MSBs deploy in implementing the core feature of their business: namely the transmission of *value* denominated in currencies other than sterling to recipients resident in overseas destinations.

2.5 Consolidation, settlement and deconsolidation in the informal sector

There is nothing mysterious about the settlement processes deployed in the 'informal' sector of the value transmission market. Whether implemented by a Bank, a specialist agency such as Western Union or through an IVTS network, the logistical challenge presented by remittance delivery remains exactly the same – and so does the broad outline of any solution. Hence it should come as not surprise that the procedures for value transfer deployed within the IVTS/Hawala networks with which I am familiar are structured in much the same way as those as those used by formally constituted banks. Directions to implement a large number of small transactions are consolidated together into large wholesale tranches, settlement is achieved by swaps of value at a central clearing house, whereupon the wholesale recipient deconsolidates the transferred value before redistributing it to its branches, which in turn make the requisite value (now denominated in another currency) available to individual recipients.

My researches show that contemporary IVTS/Hawala systems solve the logistical challenge in much they same way. They also operate their own system of in-house clearing, implemented on a daily basis, in the form of individually-brokered, hugely consolidated back-to-back value-swaps. In doing so they may at times utilise the resources of the formally constituted banking system – mainly to implement wholesale settlements in which the unit of exchange is £/$ 100,000, and only when it is infeasible to all or part of the swaps using physical transfers of currency notes. Most such mega-swaps are brokered in Dubai, and as and when appropriate settled through transfers implemented on New York's dollar-denominated money market. But whilst the underlying financial procedures deployed in IVTS networks will be familiar to any international banker, the most distinctive features of this 'informal' system – *namely the capacity of those involved to rely on relationships of trust (as opposed to much more complex and expensive bureaucratic procedures) to guarantee system security* – enables those operating such networks to meet the logistical challenge of delivering penny-packets of value to obscure and distant destinations just as reliably as their more formally constituted competitors, but to do so great deal more swiftly and above all with much lower overhead costs. The key source of their capacity to do so lies in their ability to deploy relationships of trust to guarantee the reliability of processes of consolidation, settlement and deconsolidation. As a result IVTS/Hawala networks stand in a position of substantial competitive advantage within this sector of the global financial services market.

2.6 'Informality'

Close attention needs to be paid to the precise significance of the term 'informal' when it is deployed in this context. In no way should the term be assumed to point to an absence of records. No operation of this degree of logistical complexity could be implemented reliably in the absence of the capacity to transmit information accurately and reliably between network-members. However once the issue of system-security is underpinned by relationships of trust between all participants, the scale of record-keeping and data transmission required to achieve this can be drastically reduced. In the context of a distributed system of this kind there is also no to maintain a central registry. Instead data is transmission is reduced to bilateral exchanges of information between cooperating parties within the network, and is largely restricted to that which is required to ensure the accurate implementation of the deal which has been brokered between them. Each such bilateral transaction is a component of the much more global set of transactions brokered between a network of cooperating partners, assembled, brokered and implemented on a daily basis.

The cost savings – as compared with those incurred by formally constituted banks – by implementing international/cross-currency value transfers within the context of such a coalition is enormous. However the specific character of the operation also needs to be borne in mind. Although Hawaladars implement value transfer operations of the same kind as those implemented by banks, they do not take deposits, nor do they make loans: rather theirs is a highly specialised *value-transfer* business. Moreover the essence of the whole operation is speed. Settlements are completed on a daily basis, and the core feature of the whole operation – a pair of back-to-back value swaps – is in principle implemented instantaneously.

A further feature of this 'informal' system is that it could not work (at least in its contemporary format) without access to modern communications technology. Hence a central prerequisite for participation in contemporary IVTS/Hawala transfers is electronic connectivity – by phone and fax at the very least, by broadband by preference, and where necessary by satellite phones (for those in the most remote locations) and by TT and SWIFT (for those implementing the largest-scale wholesale settlements). Given all this, the capacity of this 'informal' system to shift value on a global scale is large. Multi-million £/$ value swaps, ultimately brokered in Dubai and implemented on the New York money market are consequently a matter of routine.

2.7 The monitoring and regulation of 'informal' value flows

Given that IVTS networks operate with distributed systems with no central registry, auditors whose expectation that all financial enterprises – whether they be businesses, commercial banks, or indeed Central Banks responsible for maintaining the value of any given local currency[7] – will have a central registry in which records of all transactions will be available for inspection invariably find themselves baffled and perplexed when confronted by an IVTS network. In the absence of a central registry through which to gain an overview of the enterprise as a whole, there seems at first sight to be no obvious way of constructing an audit trail of any given transaction. However this is only so if our auditor restricts himself to examining the data at any one node in the system. Nevertheless the data he seeks will indeed be available – however given that this is a distributed system, it is held in a large number of spatially scattered locations.

Should this state of affairs be regarded as problematic? It all depends on how one chooses to set one's priorities. How far should the needs of auditors be allowed to override the priority of low-cost service delivery? And in any event, just what priorities should auditors set for themselves in this context? Is the object of the exercise prudential, or in other words to guarantee the interests of the enterprise's customers? Or is it to scrutinise these transnational operation on behalf of the state – and if so which state and for what purposes? And if so how far should the former be taxed to satisfy the needs of the latter?

Whilst I am in no position to provide answers to these undoubtedly urgent questions, I can at least contribute to the debate by dealing with one commonly asserted canard: namely that networks of the kind are 'systems without records', and hence wide open to criminal penetration. In my experience the first of these charges is manifestly untrue. IVTS/Hawala networks could not operate as efficiently and reliably as they do in the absence of procedures for accurate data transmission. Such data is normally readily accessible – although as we

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[7] Somalia has had no Government, let alone a Central Bank, for many years. However a coalition of Hawaladars has managed to ensure that the value of both the Somali and Somaliland shillings have retained remarkably stable against the US dollar over the years, in sharp contrast to the achievements of most formally constituted Central Banks to the region. See Maimbo S. "Remittances and Economic Development in Somalia: an Overview" *World Bank Social Development Paper No.38* November 2006.

have seen it will normally be distributed across several nodes in the network. Whilst this may make life more difficult for auditors, it is an open question as to how far IVTS networks should be required to organise themselves in conform to auditors' (and regulators') requirements, or whether auditors and regulators should be prepared to revise their methodologies to respond the character of the system in hand. The more the former approach is prioritised, the greater the burden of compliance costs the system's customers would have to support.

As an anthropologist who finds that he has wandered unexpectedly into this arena, I am in no position to provide a professionally-grounded response to such conundra. All I can say by way of comment is that if regulators are unable to find a way of monitoring the decentralised systems which modern communications technology has suddenly rendered feasible, retail customers seeking transmit small sums to distant destinations will be faced with a stark choice: either pay a high premium for the privilege of transferring value through the regulated sector, or take the risk – which does not appear to be particularly great in prudential terms – of using a much cheaper underground alternative.

2.8 Risk and Regulation

Risk is clearly a key issue in this context. All the available evidence suggests that IVTS/Hawala networks currently provide an extremely reliable service to their retail customers. The basic reason for this is not hard to identify. The trust-based character of the system is by no means restricted to relationships between hawaladars, but also extends to cover the relationship between hawaladars and their retail customers. Most retail hawaladars are either a member of, or closely personally involved with, the specific community they serve. They also have a reputation to keep up. Should a Hawaladar lose that reputation, or worse still be found to be cheating his customers, he not only faces the prospect of business collapse, but of finding himself and his entire extended family being driven out of the community of which they are an integral component. As Greif has observed,[8] it is for precisely this reason that coalitions of reciprocity have powerful internal sanctions which render them effectively self-policing. That is precisely why Hawaladars' customers are

[8] Greif, Avner (1993) 'Contract Enforceability and Economic institutions in Early Trade: The Maghrebi Traders' Coalition in *The American Economic Review* Vol. 83, 525 - 48.

prepared to entrust their hard-earned savings to them for transmission to distant destinations. If, then, we consider the need for regulation of IVTS/Hawala networks in terms of the Hampton principles, there appear to be good grounds for suggesting that the protection of retail customer's assets during the course of their transmission through the system should not rank high on the list of regulatory priorities.

Indeed there is no sign that recent international efforts to introduce regulatory regimes in this sphere have been driven by driven by prudential concerns, even though such concerns have sometimes been used to justify specific national initiatives. Rather the primary driving force has been one dimension or another of AML/CFT. Hence in the UK the principle objective behind the forensic interventions made by the enforcement arm of HMRC has been AML, and more specifically efforts to interdict the financial sinews' of drugs smuggling operations, whilst in the United States the nominal priority enforcement agencies has been CFT: countering the finance of terrorism.

3 Law enforcement efforts to implement AML/CFT: success or charade?

3.1 Prosecution strategies

Law enforcement agencies in both sides of the Atlantic have prosecuted a significant number of MSBs involved in IVTS/Hawala style value transfer operations. In the USA most such prosecutions have been brought in terms of infractions of state, as opposed to Federal, regulatory requirements; those responsible for the prosecution have frequently glossed their actions with suggestions that the funds in question were destined for – or at the very least might have been destined to support – terrorist activities of one kind or another. By contrast the majority of prosecutions brought against IVTS/Hawala operators in the UK by HMCE (or subsequently by HMRC) have involved proceedings either under Money-laundering legislation or the Proceeds of Crime Act, and in this case glossed with the suggestion that the funds in question were – or could only be reasonably be regarded as being – the profits generated as a result of the import of Class A drugs. However closer examination of the fine detail of these prosecutions reveals striking parallels between developments in the two jurisdictions, despite the wide differences in the ways in which the prosecutions on either side of the Atlantic have been and continue to be justified.

3.2 The pursuit of terrorists in the United States.

The Department of Homeland Security has no doubts about the extent to which the regulatory initiatives stemming from the Patriot Act had proved to be a highly effective tool for keeping the terrorist threat at bay. In a press release dated 14th December 2005, it announced that

> Another system that has proven vulnerable to exploitation by criminal and terrorist organizations involves money transmittal businesses and related hawalas. Using new provisions of the Patriot Act, ICE has launched a nationwide campaign against illegal/unlicensed money transmittal businesses that has resulted in the arrest of more than 155 individuals and 142 criminal indictments, over $25 million in illicit profits seized, and several unlicensed money transmittal businesses shut down.

The press release went on to list twelve examples of the prosecutions brought by ICE, of which for convenience sake I will only cite the first here:

> On September 22, 2005, a key player in a scheme to illegally transfer more than $100 million to Pakistan through a New Jersey money transmittal business was sentenced to nearly four years in prison as a result of an investigation by ICE and IRS agents. Umer Darr, a Pakistani native and naturalized U.S. citizen was first arrested in June 2003 along with five other men. ICE agents found that Darr and his associates were affiliated with a money transmitting firm called Access Inc. of USA, which operated out of a small, upstairs apartment of a suburban house. The business kept an unlisted number; did not advertise in the Yellow Pages, and could only be accessed through an unmarked rear door. Yet through this small hidden business, more than $100 million in virtually untraceable funds were illegally moved to Pakistan. Several defendants in this ongoing case have been convicted.

However the reality of these much trumpeted successes has recently been subjected to a searching critique by Professor Nikos Passas of the College of Criminal Justice at Northeastern University, Boston in an article entitled "*Fighting Terror with Error: the counter-productive regulation of informal value transfers*", which is the outcome of research sponsored by a grant from US National Institute of Justice and further supported by the World Bank. Passas neatly summarizes his argument in the abstract which precedes his article:

> This paper challenges the widely shared view that the United States and international frameworks regulating terrorist finance and money laundering (AML/CFT) is productive and effective. Through a careful look at the evidence regarding the formal and informal fund transfer systems, this paper shows that security, crime control and economic policy objectives are systematically frustrated by ill-conceived and misapplied rules. US federal and state regulations in particular illustrate how unrealistic, unaffordable and counter-productive are current arrangements. The paper concludes with some suggestions about how to reverse the ongoing fact-free policy making process.[9]

[9] In *Crime, Law and Social Change*, Vol. , published on-line by Springer Netherlands on 14th November 2006, available online at http://dx.doi.org/10.1007/s10611-006-9041-5

Given that Passas article is readily available, I will not attempt to further summarise the burden of his argument here; instead I will simply refer to his analysis as and when it serves to illuminate my own analysis of developments in the UK.

3.3 The pursuit of money launderers in the UK

HMRC's concern with the prospect that MSBs might be a vehicle by means of which drugs smugglers might transmit their profits to safe havens overseas antedates the 9/11 atrocities. Following the collapse of the 'controlled delivery' strategy by means of which its officers had sought to infiltrate Pakistani drugs smugglers' delivery networks,[10] from 2000 onwards HMRC developed an alternative approach: one which sought to attack the 'financial sinews' of these smuggling operations. This was publicly signalled in an article in the Observer on July 8, 2001, in which David Rose reported that

> At present, about a quarter of the 1,200 UK Customs investigators devoted to fighting the drugs trade work mainly in following the huge amounts of money involved, a proportion which is set to triple over the next two years. Again, there have been significant recent successes. In one pending prosecution, it is alleged that a network of bogus travel agencies laundered more than £1bn over three years on behalf of Turkish and Pakistani traffickers, channelling funds from Britain via Dubai to Pakistan.

The 'pending prosecution' to which this article refers appears to be the three West Yorkshire 'Hawala' trials in which I was instructed to act as an expert witness. Even though the transactions with respect to which these prosecutions were brought antedated the introduction of the regulatory regime with which this review is concerned, the precise circumstances in which they were brought, as well as their outcomes, are nevertheless worth reviewing.

Prior to HMCE's intervention none of the three businesses were operating underground. Indeed precisely because they were processing large volumes of cash they had arrangements with Securicor to make delivery of ready-counted and bundled boxes of currency notes with their bank, together with arrangements to convert those deposits into US$, and to transmit large tranches of value into accounts located overseas – mostly to Wall Street Banks – as and when directed. Having eventually accepted that all three businesses were at least in part

[10] Although HMRC initially suggested that they had been forced to abandon the controlled delivery strategy as a result of objections by 'clever lawyers', when the Court of Appeal finally came to review all these operations more than seven years later, the conclusions which Lord Justice Hooper and his colleagues reached in their judgement ([2005] EWCA Crim 1788) can only be described as scabrous. In addition to finding that HMCE officers at many levels in the organisation had acted in ways which were comprehensively in breach of due process, they also found that a number of DLOs had not only allowed participating informants to run rings around them, but that they had also been engaged in the import of heroin on their own account. So severe was these deficiencies that in a subsequent hearing

involved in the delivery of migrant remittances to Pakistan, the prosecution case eventually homed in on two classes of value transfer which it insisted could only sensibly be explained as efforts to launder illegally generated funds: on the one hand the delivery of large consignments of currency notes by couriers who typically arrived from elsewhere by car at the Hawaldars' offices, and secondly the transfer of equally large sums – often in tranches of $100,000 – to destinations other than Pakistan.

Come the trials, I suggested firstly that there was nothing inherently suspicious in transactions which were ordered in this way, in the sense that they were precisely what one would expect to observe if they represented the initial processes of consolidation and settlement which were precursors to much larger back-to-back swaps being brokered global hawaladars operating out of Dubai, and with whom the consolidating hawaladars who found themselves on trial had also arranged deals for the delivery of rupees in Pakistan. I also pointed out that the prosecution had little or no concrete evidence showing that the funds in question were indeed the profits accruing from the import and sale of drugs, and that there was circumstantial evidence to suggest that they could equally well have come from local Hawaladars dealing with migrant remittances who lacked foreign exchange accounts of their own, and/or from Pakistani businessmen involved in importing goods from overseas who chose to settle their suppliers' invoices by means of Hawala transfers. However in the jury were unimpressed by the defence arguments, and in all three cases the defendants were found guilty.

However two of these cases eventually came back to the court of appeal, where those verdicts were quashed on the grounds that "the jury *should not have been directed to convict if a defendant only suspected* that at least part of the money he was dealing with was another person's proceeds of drug trafficking" ([2005] EWCA Crim 87, para 139). All three cases have by now been sent back for a fresh hearing.

The substantive issue at stake here was the provenance of the funds processed by the accused Hawaladars. Were the consignments of funds identified above the proceeds of drugs smuggling which the defendants had deliberately muddled up with funds of legitimate origin, the better to obscure the fact that they had contravened the money-laundering regulations, as

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they ruled that HMRC should pay 70% of the appellants' costs [2005] EWCA Crim 2598.

the prosecution believed but was unable concretely to demonstrate, or was the whole operation part and part of a wider back-to-back hawala swap? In various guises all the subsequent prosecutions of IVTS/Hawala operators brought by HMCE and subsequently by HMRC have all in one way or another encountered the same conundrum.

3.4 The reaction of IVTS/Hawala operators to the new regulatory regime

Partly as a result of HMCE's successful prosecution of the West Yorkshire Hawaladars, and partly as a result of the introduction of the new regulatory regime, the many other IVTS/Hawala operators serving members of Britain's 2 million strong South Asian community changed their *modus operandi*, not least by registering themselves with Customs and Excise, and bring their operation into compliance with NYC requirements and so forth. What is must less clear, however, is how far and in what ways they adapted their settlement processes. They clearly faced a major conundrum in that respect. On the one hand the prosecution had successfully convinced juries that the settlement processes deployed by the West Yorkshire Hawaladars were a vehicle for laundering drugs money; but on the other the settlement processes which they themselves utilised, and were the key to their whole financial operation, were – or so I would suggest – closely akin to those deployed by the West Yorkshire Hawaladars. But in a further paradox the new regulations did not provide any guidance as to how those settlement processes should be implemented, nor do Customs inspectors appear to have raised the issue during the course of their compliance visits.

So far as I can see – and I would not claim to have a great deal of knowledge about recent developments, since most operators prefer to hold their cards very close to their chests – there change appears to have taken place in three main directions.

i. Many local operators appear to have formally registered themselves as agents of larger operators.

ii. A significant number of local operators who had formerly relied on the successfully prosecuted hawaladars' consolidation and dollar conversion services opened foreign exchange accounts of their own.

iii. There has been a substantial increase in the volume of back-to-back swaps brokered in sterling rather than US dollars, leading to a sharp increase in physical cash swaps between UK-based hawaladars.

I must confess that I have little concrete evidence of the extent of the first two developments: my conclusions are entirely impressionistic. The HMRC register of MSBs will contain the information to confirm or refute the fist point, but unfortunately the contents of the register are not made public. HMRC may or may not have data on the second point. However I do

have some concrete data on the third point, largely – once again – as a result of being instructed to act as an expert witness. In doing so I have observed that a growing number of prosecutions have been brought not so much against MSB operators themselves, but of the agents and gophers handling the cash transfers between UK-based hawaladars between whom value swaps had been brokered.

3.5 Cash settlements and their vulnerability

As in all sophisticated forex operations, not least those conducted through the formal banking sector, IVTS/Hawala operations rarely lead to the export of cash from the UK. Instead those involved in such operations have devised a highly efficient system of back-to-back transnational settlements swaps, which operate on the lines which I have set out in the model discussed in my article on Hawala in the Internal Institute of Asian Studies Newsletter. This takes the form of the regular implementation of two matched swaps of equal value, one denominated in sterling in the UK, and the other in Rupees in Pakistan. However it goes without saying that the physical transfer of tranches of cash worth £100,000 is a risky activity.

In order to cut these risks, whilst also concealing the precise character of the deals they have from rival hawaladars with whom they are competing for business, UK based Hawaladars have for some years used trusted gophers to implement such cash transfers. The gophers are never insiders to the deals themselves, and most usually the transfer of cash takes place between gophers, so the principals – having negotiated a deal with higher level global hawaladars – are insulated from one another by an anonymous cut-out. Meanwhile the gophers themselves effect the cash transfer in some secluded but nevertheless easily accessible spot, such as the nether reaches of a supermarket or motorway service station car park.

However in a significant number of money-laundering cases which have recently come before the courts, a snatch squad of Customs Officers was lying in wait at the spot where the transfer was to take place. The moment the recipient took delivery of the consignment of cash he was arrested, and charged with money laundering. Strikingly, in most of the cases of which I am aware Customs Officers made little or no effort to identify where the cash of which the arrested gopher had taken delivery came from. Nor (thanks to a successful PII application) was the prosecution required to identify how and where they gained access to the

information that enabled to stake out the delivery spot. In these circumstances the gopher and the principal by whom he was employed invariably found themselves hard-pressed to explain where the cash in question came from: hence they were vulnerable to prosecution suggestions that the only reasonable explanation was that the cash was of criminal provenance, and that the defendants knew that it was of such provenance.

3.6 Why implement settlements by cash transfers rather than by bank transfer

Arguments in court inevitably led to a further question: if this was indeed a value transfer made as part and parcel of a deal between Hawaladars – as my model suggested it could be – why go through the dangerous rigmarole of making physical deliveries of large sums of cash. Why not send it through banking channels? My initial answer to this conundrum was a practical one: since Hawaladars dealt in cash, and the cost of counting, bundling and depositing large sums of cash was at least equal to and possibly more expensive than instructing gophers to make a physical delivery, and given that such value-transfers were immediate rather than being subject to the banking system's routine three working days delay to allow for settlement, the advantages accruing from making physical deliveries of cash outweighed the associated risks.

However it was not until I read my colleague Nikos Passas recent article that I realised that there was a further potential explanation. If UK banks are becoming as cautious as their US counterparts about holding accounts of MSB operators, it could well be that if their bankers were to note that they were making regular transfers of £100,000, as well as receiving regularly receiving tranches of a similar size, their suspicions would be aroused, and their accounts closed. If this is indeed the case in the UK as well as in the US – and I should emphasise that at present I have no concrete information which points one way or the other – it would be a further example of the precisely the kind of outcome which so concerns Passas: the implementation of regulatory requirements in such clumsy fashion that it makes such operations more, not less, vulnerable to criminal penetration by actively preventing IVTS/Hawala operators from using the resources of the banking system to conduct crucial aspects of their business.

3.7 Catch 22

That said, the current legal and regulatory system still provides prosecutors with all sorts of loopholes through which to squeeze. In one recent case in which I was instructed to prepare

an export report, the defendant was arrested in a service station car park on the M1, the moment he took delivery of a bag containing £60,000 handed over to him from another man who had just parked beside his car. A party of Customs Officers had been lying in wait, and charged the defendant with being involved in laundering criminally acquired funds. The defendant protested that he was a businessman in Pakistan, and that in exchange for the deposit of rupees to a similar value, he had arranged with a hawaladar in the UK for the money to be delivered to him in sterling in the UK, so enabling him to settle his UK suppliers' invoices. In preparing I report I indicated that in my opinion such a business practice was entirely plausible, and that in that case it was reasonable to assume that the man from whom the defendant had received cash was a gopher operating on behalf of a UK hawaladar. I also noted a perplexing feature of the prosecution case. HMCR officers knew enough about the prospective transaction in advance to be able to stake out the car park; in consequence they must have known something about the man who made the delivery, and would therefore have had an opportunity to check out the (allegedly criminal) origins of the cash in question. Yet HMRC had did not bring any charges against the gopher, and were also successfully in mounting a PII application which enabled them to avoid giving any background evidence as to how they came to make the stakeout.

However when the case came to trial and the prosecution were presented with my report by the defence, they promptly asked for an adjournment to consider its contents. After some while they decided to present no evidence on the money-laundering charges, so the defendant was released – only to be arrested once again under the terms of POCA. No new evidence was presented, but when the POCA trial went ahead it was in the magistrates' court, where the only issue at stake was the provenance of the funds in question, and the test was only at the civil level, or in other words the balance of probabilities rather than beyond reasonable doubt. The District Judge ruled in favour of HMRC, and the cash was duly confiscated – primarily because its recipient was quite unable to specify just where the cash in question had come from.

3.8 Regulatory uncertainties as a source of risk

We are back with our conundrum once again. If I am right in concluding that a substantial number of UK-based IVTS/Hawala operators routinely implement cash deliveries of the kind which I outline in my model, are they acting illegally? That they are risky is quite clear: but paradoxically enough one of the greatest sources of risk is not just that criminals might make

a raid in an effort to grab one of the consolidated tranches cash that had been put together to implement such a swap,[11] but that in the processes of making the transfer Customs officers might swoop in the manner just indicated, and bring charges against the recipient under either POCA or on AML grounds.

Of course there might well be circumstances in which a raid of this kind might be entirely justified. However that is not the point I am seeking to make here. The issue which concerns me is whether or not the back-to-back swaps between cooperating Hawaladars of the kind I describe in my model are, or are not, legitimate and above board. So far as I can see – and I should stress here that my professional status is that of an anthropologist, not a lawyer or an accountant – there is nothing illegal about the implementation of such value swaps in UK law, always provided that the funds in question are not of criminal origin. Moreover this appears to be confirmed, although only *en passant*, in the reference to 'offsetting liabilities' in para 4.1 of the consultation document. However so far as I am aware at no point has HMRC explicitly acknowledged that settlement swaps of this kind are indeed illegitimate. Moreover in many of the cases brought by the courts by HMRC, the prosecution has made use of statements made by Mr. Richard Lowe, formerly of HMCE and now of SOCA, in which he seeks to draw a radical distinction between 'true hawala' and money laundering. With this in mind he suggests that:

> Hawala persists as a system of cheap and effective remittance. Hawaladars operate within small communities in the UK. They do not and can not advertise, but are personally known to members of the community…. they only service their own community … Hawala services are not available to strangers or people outside the ethnic community they service. True Hawaladar are also increasingly limited by the amounts of cash they can handle. They have to be able to realise the value of the cash they receive.

Having identified 'true hawaladars' as being small-scale operators serving specific local communities, but without at any stage considering just how the operators of such MSBs actually implement the transfer of value to their distributing partners overseas, Mr. Lowe goes on to contrast their activities with those of money launderers, in which 'Controllers' – who he suggests most usually operate out of Dubai, and who is

> making money on his genuine transfers out of Middle East or Pakistan, but using them to legitimise his money laundering in the UK. He gets paid twice to launder the money by using "back to back transfers" – one legitimate and one criminal. The collector in the UK will be able to say where the money is going and prove it is legitimate, but will not be able to justify where the cash is coming from.

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[11] The raiders who shot PC Sharon Beshenivsky outside the Universal Express Travel Agency/MSB in Bradford in November 2005 were seeking to lay their hands on just such a cash consignment.

> There will not be corresponding legitimate documented transfers going the other way. Explaining the source of the cash and unallocated cash held is the key problem for a collector when arrested. The Controllers key to success is being able to provide a ready supply of genuine transactions to allow the collector to quickly dispose of the criminal cash and his ability to balance the books to ensure quick payment. He may buy legitimate transactions from third parties to ensure he has enough UK recipients for the dirty cash. The controller may operate holding accounts in the UK where the cash can be securely deposited to avoid holding onto cash. Where they collect more cash than they have legitimate transactions to cover, they will build up a stash of bank notes awaiting deposit.

When closely examined it soon becomes clear that Mr. Lowe's model of 'back-to-back transfers' is clearly wholly compatible with my own: indeed I suspect he may well have borrowed the phrase from my own account of how the system operates. But at the same time it is much narrower in scope. In the first place his model takes it for granted that the central motivation behind the whole exercise is criminal. As a result he regularly argues that even if the source of cash in the instant proceedings is unknown, it is nevertheless safe to conclude that if transactions are structured in the way he describes, the cash in question *must* be dirty, and hence of criminal origin.

Secondly, and just as significantly, he seeks to draw an absolute to distinction between 'true hawala', which he identifies as operating on a small scale and within the context of specific local communities (although with no visible means of implementing the settlement processes which are a necessary prerequisite of low-cost value transfers), and a system of much larger scale back-to-back value swaps through which settlements are clearly being implemented, but which he insists are primarily criminally driven, and hence nothing to do with true hawala – although they would appear to be congruent with the 'offsetting liabilities' referred to in section 4.1 of the consultation document.

Whether my own or Mr. Lowe's model of what is going on in this sphere is, of course, currently being hotly contested in the courts. However as yet the matter remains unresolved, and so long as IVTS/Hawala operators are implementing back-to-back settlement swaps which give rise to large wholesale cash transfers in the UK, they are vulnerable to suggestions that their activities are congruent with Mr. Lowe's model of money laundering, and to all the consequences that might arise therefrom.

Faced with this kind of Catch22, it seems to me entirely rational for IVTS/Hawala operators to keep their heads well below the parapet. Moreover if this is indeed the case, it goes a long way towards explaining why the authorities – from the FSA through the Treasury to DFID –

should have encountered such difficulty in persuading operators in this section of the Financial Services Industry to enter into any kind of dialogue with them.

As a popular Punjabi epigram puts it, no-one in their right mind puts their hand into a basket full of snakes, no matter how much its occupants may insist that their fangs are entirely harmless.

4 The regulatory challenge

4.1 The challenge

Despite all these cautionary tales, I would in no way wish to suggest that IVTS/Hawala operations should not be subjected to regulation. Given the volume of funds processed through such networks – no less in a UK than a global context – it is only reasonable to expect this sector of the financial services sector should be subject to regulation. However the central challenge in designing such a regulatory structure lies in accurately identifying the location and character of its most pressing sources of vulnerability, and in designing a framework through which to monitor its operation on a basis which targets those most likely sources of malfeasance on an effective basis.

4.2 Current regulatory priorities

Anyone newcomer to the field who read the consultation document would swiftly come to at least two conclusions. Firstly that the current regulatory regime for MSBs was formulated on a distinctly *ad hoc* basis, and that its requirements are very loosely formulated; and secondly that its objectives are overwhelmingly directed towards achieving AML/CFT compliance in this sector of the financial services industry. Hence over and above formal registration (with very few prerequisites), central emphasis is on KYC, record keeping and the capacity to generate SARs in appropriate circumstances. The objective of these measures is to prevent criminally-acquired funds from being laundered through the MSB sector.

Whilst it is by no means clear as to how far the AML/CFT measures with which the entire UK financial services sector is currently required to comply has actually facilitated the achievement of those goals, their introduction certainly not been consequence-free. Besides

incurring substantial compliance costs,[12] institutions in the formal sector have become substantially more risk-averse. However so far as I am aware no-one has suggested that the introduction of the effect of these measures has been to drive terrorists and drugs smugglers out of business. The best that can possibly be expected of the whole exercise is that funds used by terrorists and drugs smugglers *may* have been driven out of the regulated sector of into its more obscure and less regulated corners, and that at least in principle, IVTS/Hawala networks *may* be one of those corners.[13]

4.3 A comparison with experience in the United States

Of course the UK is by no means the only jurisdiction which has been facing up to potential challenges in this sphere. Following the shock of the events of 9/11, the US has been pursuing similar objectives with great determination. However in the US, as in the UK, there is little evidence that all these efforts have produced much in the way of concrete results. In the course of his close examination of the impact of the implementation of a parallel set of regulatory procedures which have been implemented in the United States, Professor Passas poses three key questions:

- How many terrorist or serious criminal acts have been prevented or detected through measures directed at monitoring the activities of money transmitters in the IVTS sector?
- Are the control and regulatory priorities commensurate with evidence of risk and vulnerabilities?
- At what costs have any anti-crime successes been achieved?

If the answers Passas offers must have made depressing reading for the architects of the AML/CFT initiative in Washington DC:

> Critical as financial controls are, they are no panacea and have their own externalities. There is no systematic and thorough evaluation of the effectiveness and efficiency of current approaches, as evidence and arguments reveal unintended consequences. The aggressive and controversial law enforcement has yielded no terrorism charges so far ... In other words we are fighting a war on terror and shooting ourselves in the foot.

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[12] *Anti-Money Laundering Requirements: Costs, Benefits And Perceptions* City Research Series No.6 Corporation of London, 2005 estimated that annual compliance costs inn the UK amounted to arounf £250 million per annum, and in the USA to be in the order of £1.2 billion. The text includes a particularly revealing comment from a Partner in a UK-based accounting firm: "*Whilst we go through the motions and comply with AMLR, I am absolutely certain that nothing we do will deter an organised criminal"*

[13] Any such argument rests on the assumption that little in the way of money-laundering goes on in the formally constituted financial sector, and that current AML/CFT procedures will serve largely to eliminate what is still there. Any such assumptions are magisterially undermined in Raymond Baker's recent study *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* Wiley: Hoboken, New Jersey 2005.

Of course the issues in this side of the Atlantic have largely been addressed with issues of AML rather than those of CFT, but if there is any substance to Passas' conclusions, the same questions are worth posing in a UK context.

4.4 A regulatory approach which leaks like a colander

In my personal opinion, little if any of the funds which flows through IVTS/Hawala networks is of criminal origin. Nevertheless with Passas analysis in mind, the obvious questions are still worth asking. Firstly if criminally generated funds were to be passed through passed through the UK-based arms of IVTS/Hawala networks, what are the prospects of such transactions being detected, and of the criminal perpetrators being prosecuted, as a result of the controls which have been set in place by the present regulatory system? Secondly, and just as importantly, how far can we be certain that the prosecutions that have been brought against IVTS/Hawala operators involved funds which were actually – rather than simply being suspected to be – of criminal origin? In my view the answers which must currently be given to both questions is most alarming. For all the effort which has been put into their construction, the current regulations are so narrowly focused as to leave the such networks wide open – at least in principle – to criminal penetration to occur without detection, whilst simultaneously also opening transactions which are in all probability entirely licit in character wide open to criminal prosecution.

If my model of how IVTS/Hawala networks operate is correct, it is exceedingly unlikely that any serious criminal who was aware of the existence of such networks would be so naïve walk in through the front door of a Money Transmitter, seeking transfer a large sum of cash overseas. Assuming our criminal has any degree of business competence, he would employ a more roundabout approach. Rather than approach a retail Hawaladar, he would make contact with a consolidating Hawaladar operating at the next stage up. Such a Hawaladar might well have his own front office, as well as a string of retail agents, each of whom maintain front offices of their own. In these circumstances the best route of entry for our hypothetical criminal would be to do a deal at the wholesale/back-office level – always assuming that the hawaladar was prepared to do business with him. In these circumstances it is would be easy for the consolidator to wrap up a further substantial sum in one the much larger tranches of value which he was consolidating in the process of implementing his routine back-to-back swaps, into which the cash of criminal origin could readily be incorporated.

Given the regulatory procedures currently deployed by HMRC, a transaction of this kind would almost certainly remain entirely invisible, since *the consolidation procedures necessarily employed in Money Transmitter's back offices are not at present is not subject to any kind of inspection or regulation.* However precisely because all the transactions which occur in the process of consolidation and settlement currently take place in what can best be described as a 'grey area', such that they can be – and very occasionally are – picked up by 'snatch squads' deployed by the enforcement arm of HMRC, it is in no sense in Hawaladars' interests to say a word about these operations, no matter how confident they may be that the tranches of funds so exchanged contain no funds of criminal origin. Since such transactions are congruent with Mr. Lowe's model of money-laundering, there is still a prospect that they could find themselves facing – and even being found guilty of – criminal charges, no matter how vigorous their protests of innocence.

If this analysis is correct, the consequences of the current regulatory structure produces what can only be described as the worst of all worlds:

- The regulations are unlikely to detect criminal infiltration, if and when such infiltration were to take place
- The regulations open those whose as activities are in all probability not inherently criminal open to criminal prosecution
- And therefore provide all those involved with a positive disincentive to fully cooperative with the authorities, for fear that they might themselves be subjected to prosecution

4.5 Stopping the loophole

That there is a major loophole here is self-evident. How, though, are loopholes of this kind best stopped? Before stepping into the breach with a blunderbuss, two critical questions are worth asking. Firstly, how great is the risk that any given Hawaladar might accept funds he knew or suspected to be a criminal origin? Secondly, if such an approach were to take place, what measures would be most likely to persuade him to report such an approach to the authorities, and to enhance the prospect of the transaction being detected if he was indeed to succumb to the temptation and accept the proposition?

With respect to the first question, several points are worth noting. Most obviously he risks being detected by the authorities – and all the sanctions which would follow – by accepting

such business. But that is not all. Hawala networks are coalitions of reciprocity, and as Greif has shown, such networks contain their own internal mechanisms of self-regulation. In these circumstances members of such networks are under very significant additional pressure not to accept illegitimate business. To do so would threaten the integrity of the entire coalition if his partners became aware of it, regardless of whether on not his malfeasance came to the attention of the authorities. In such circumstances the coalition's internal regulatory mechanism would promptly to swing into action, such that the errant Hawaladar was frozen out of the network, and hence of business.[14]

Can these internal self-regulatory mechanisms be regarded as a sufficient means of containing the risk of criminal penetration? Whilst I am in no position to provide an answer to that question, I would nevertheless urge anyone contemplating the introduction of regulatory measures not to overlook both the presence and the effectiveness of these internal mechanisms, not least because they form the outer wall of a highly effective breakwater. In these circumstances it makes much better sense to reinforce those barriers than to overlook them, let alone undermine them.

How, though, might this best be achieved? In my view any sensible form of regulatory scrutiny needs to be extended well beyond the current practice of examining KYC-compliance in front-office contexts, and in doing so take cognisance of back-office processes of consolidation and settlement as well. But to be effective such measure would have to be implemented with care. The introduction of a regulatory framework which insisted that the operators of such networks should add an identity tag to each scrap of value at every stage in its passage though the system, including every stage of the settlement process, would effectively require IVTS networks to set about the task of transnational value transfer system using exactly the same bureaucratically-intensive procedures as old-fashioned banks. In such circumstances many aspects of the sophisticated response to the logistical challenge of delivering migrant remittances to remote destinations in the developing world promptly be undermined, and their current position of competitive advantage over the formal Banking

[14] This internal self-regulatory network also serves as a highly effective prudential guarantee. Any participating Hawaladar who betrays his partners or clients by embezzling the funds with which he has been entrusted will not only be promptly expelled from the network, but his entire extended family will also be permanently shunned by all the global components of the entire community to which they belong. In other words the consequences of a betrayal of trust within the context of such a network are exceptionally severe.

sector would be eliminated, and in all probability be reversed. In such circumstances the cost of delivering migrant remittances to distant destinations through regulated transmission agencies could be expected to rise significantly.

This would not be a particularly effective solution to the totality of the underlying issues. In the face of increased compliance costs, which they would inevitably have to pass on to their customers, many IVTS/Hawala operators would be likely to find themselves driven out of business – unless they chose to disappear underground. Were they to do so they could expect to find that many customers would remain be eager to use their unregulated services, especially if their cost structure was dramatically lower than that which applied in the regulated sector.[15] Would this be worth the candle? A central feature of trust-based informal networks is that they can disappear from public view with relative ease. But if significant number of IVTS/Hawala operators were to execute this kind of disappearing trick, it is worth asking whether this would render their networks more or less attractive to those with criminally acquired funds in search of a laundry? And if this occurred, would it increase or decrease the prospects of the authorities tracking down drugs smugglers and other criminals by tracing the financial sinews on which they relied to support their nefarious activities?

With such considerations in mind I am deeply sceptical whether the measures set out in the present consultation document – which effectively amount to a tightening up of, and much stricter enforcement of, the procedures with which MSBs are currently expected to comply – would bring any significant advantages from a law enforcement perspective. In the first place the current measures are not designed to catch criminals, but rather to exclude their cash from the financial market place. Secondly there is no sign that the introduction of a very much more rigorous framework of financial regulation – akin to those in force in Germany and the Netherlands, for example – would produce any better result. To be sure in such circumstances many IVTS/Hawala money transmitters might consequently find themselves unable to meet the cost and administrative complexities of compliance. However rather than simply going out of business, many might simply take step to alter their business model, either by transferring the greater part of their consolidation and settlement processes overseas, hence

[15] So far as I can see this is precisely the current state of affairs in all those jurisdictions where all those involved in the money transmission business are required to register themselves as banks, and to conform to the full panoply of requirements which this entails.

putting them beyond the reach of UK-based regulators, and/or by taking the UK-based dimensions of their activities underground – as already seems to have occurred in Germany and Holland.

Alternative approaches are however available. As we have seen given their structure as coalitions of reciprocity, IVTS/Hawala networks already sustain their own internal structures of self-regulation which work very effectively from a prudential perspective, and at least arguably so as far as the exclusion of 'dirty money' is concerned as well. In these circumstances it an approach which sought to reinforce those internal structures, and thereby to reinforce the existing belt with an additional pair of braces would appear to make much better sense. If the braces on offer are constructed with no reference to the existing belt, and threaten not so much to help keep the trousers at waist level but raise them to the throat, a different outcome seems far more likely. Rather than reinforcing the belt, such measures would be much more likely to cause trousers and their wearers to make themselves scarce.

In the light of such considerations the rest of this response has been prepared in an effort to develop some more positive – and realistic – suggestions about the way in regulatory, and above all crime-prevention and -detection measures in this arena might be implemented.

5 Conclusion: some realistic suggestions for the better regulation of IVTS/Hawala MSBs

Given the ad hoc basis on which the current registration scheme was initially constructed, and looseness with which the various elements of the scheme are currently monitored and enforced, the current review is most welcome. What is much less clear is whether a systematic tightening up the diligence with which MSBs comply with data-recording and reporting requirements, together with much more severe penalties for failure to comply with these requirement will enhance the prospect of the authorities being able to detect the presence of criminal funds flowing through the system, use the opportunity to back-track their way to the criminals who generated such funds in the first place. I take the view that that is most unlikely. On the contrary the measures now envisaged seem much more likely to have the effect of deepening the current morass. With that in mind I would like to offer the following tentative proposals as to how the issues might be more effectively approached.

5.1 Recognise reality

The current consultation document provides no clear indication that those who formulated the proposals it contains had a clear understanding as to how the IVTS/businesses which it seek to bring within a more comprehensive regulatory purview actually set about implementing their core business: meeting the logistical challenge of transnational/transcurrency value transmission, in such a way as to facilitate the delivering small packets of value swiftly, cheaply and on a reliable basis to remote destinations.

To my mind an effort to design a regulatory framework for a set of financial operations whose character is largely unknown, and hence in all probability misunderstood, can only be regarded as foolhardy.

If so, one of the most urgent current priorities must, of necessity, be to conduct a serious and objective exploration of the operating procedures which underpin this particular form of contemporary transnational value exchange. So far as I am aware, my own model of how the system works is the only fully configured *financial* explanation of the operation of IVTS/Hawala currently available. This is not to suggest that there is no prospect of my model being improved upon, or exclude the prospect that Hawaladars will not (and indeed have not already) developed all sorts of variation on my basic scheme. That said, model could at least be used to provide a starting point for further empirical research. The results of such an exercise would undoubtedly be most illuminating.

5.2 Seek the cooperation of those whose businesses are to be regulated

Such a research project could only be undertaken with the cooperation of IVTS/Hawala operators themselves. Likewise effective implementation of the consultation process, let alone of the subsequent process of implementation is likely to be far smoother if carried out with their cooperation. Whilst I get the impression that the vast majority of Money Transmitters have by now registered themselves with HMRC, it is much less clear as to how far this has opened up an arena in which mutual communication flows back and forth between HMRC staff and MSB operators. My impression is that so far, at least, the flow of information has overwhelmingly one-way in character, most especially in the case of the smaller MSBs with which this consultation is primarily concerned.

I also understand that both DFID and the Treasury have had considerable difficulty in persuading anyone in this sector to come forward to participate actively in discussions as to how the current regulatory framework might be improved. In my view this should come as no surprise. So far, at least, the only face-to-face contacts which most Money Transmitters have had with the authorities has been visits Customs Officers, whose central task has been to instruct them as to how they should organising their business practices in order to ensure that they comply with regulatory requirements. In these circumstances their role was primarily to issue directives, rather than to gain a sympathetic understanding of the business operations in question. Likewise anyone who has looked at official pronouncements with respect to their activities would swiftly appreciate that a core objective of current policy is to reduce the flow of remittances passing through the informal channels and to encourage their redirection into the properly regulated formal sector.

Moreover it is most unclear as to where the boundaries between those two spheres can best be regarded as lying. Given the widespread use of back-to-back swaps facilitate settlement, it is by no means clear on which side of the boundary those operating in this grey area should regard their activities as falling. Given that the current consultation document does not clarify this issue, it is entirely understandable that those who have been placed in this uncomfortably interstitial position should be extremely cautious about showing their hands.

5.3 Improve communication

This is most unfortunate. By common consent no regulatory scheme is likely to be effective without the participation of those whose activities are to be regulated in planning the regulatory framework, and their on-going cooperation when the regulations are rolled out. Nor, in my view, is better communication beyond reach. All my conversations with those involved in running Money Transmission Businesses indicates that they would welcome the prospect being brought under a properly constituted regulatory umbrella. However they invariably accompany that view with two crucial provisos. First that any such regulatory framework should be prepared to recognise and accept the basic logic of their business models they deploy; and secondly that regulatory process should not be so costly as to drive them out of business, and above that it should not mindlessly criminalise their current business practices. Whilst the regulators and the regulated have substantial common interests, *mutual* communication between them in this sphere is currently exceedingly poor, and hence in urgent need of improvement. However such an improvement is most unlikely to occur

unless the regulatory authorities have, *and are perceived to have*, a much more sympathetic understanding of the circumstances in which transnational Money Transmitters find themselves operating, and the requirements of the market which they serve.

In the UK as in all other financial jurisdiction in the developed world, migrant remittances are now a substantial component of the personal financial services sector. As a working rule of thumb, a reasonable starting point is that by value 50% of these remittances are transmitted are transferred through the informal sector. However despite the scale of this market (£2 billion per annum in the UK?), as businesses the great majority of Money Transmitters do not even rate as minnows in comparison with LLPs and LLCs in the financial services industry with which the Treasury, the FSA and HMRC routinely deal. IVTS/Hawaladar operators do not employ solicitors and accountants in-house, nor do they turn to major agencies in the City for expert advice. Very often English is not their first language, nor is it necessarily the language in which the conduct their business operations: indeed one of the central reasons why they are able to provide such an effective service to their customers is precisely their familiarity with non-English as well as English social, cultural and linguistic systems, no less at the proximate than at the distant end of the delivery chains which they operate.

Although much of what they do may consequently be ordered in ways unfamiliar to English observers, this should not be regarded as being an *ipso facto* cause for concern. Rather such capabilities are better regarded as an intrinsic component of their business model.

5.4 Refine the objectives of regulatory activity

The present regulatory structure appears to have been constructed with exceptionally narrow in mind: compliance with AML/CFT requirements, in order to establish a line of defence against the prospect of terrorists and drugs smugglers transferring funds overseas. However in this sphere as in all others where AML/CFT rules have been brought into force, there is no obvious sign that these initiatives have led to the identification and prosecution of terrorists and drug smugglers on any significant scale. Despite the vast and ever-escalating cost of compliance in this sector, whose impact has of course been heaviest of all on major financial institutions in the City,[16] there are good reasons for suggesting that the greatest regulatory achievement of these measures has been to keep the elephants at bay.

[16] *Anti-Money Laundering Requirements: Costs, Benefits And Perceptions* City Research Series No.6 Corporation of London, 2005

That this should be so should come as no surprise: as they stand the current AML/CFT regulations not designed as a means of *catching* terrorists and drug smugglers,[17] but rather to restrict their ability to utilise the resources of the financial services sector to support their nefarious activities. However I suspect I am not alone in feeling that I could sleep more easily in my bed if the central aim of the initiative was to facilitate the identification and prosecution of active terrorists and drugs smugglers, rather than to demonstrate that the elephants have successfully been kept at bay. To be sure regulatory crack-downs – whether aimed at the financial services sector as a whole, or highlighted in criminal prosecutions directed at Hawaladars who protest that all they are doing is implementing multi-million pound hawala-style value swaps – play out extremely well in terms of public relations. However they also have an impact on the real financial world.

Firstly they impose significant costs on the customers of the financial services industry, from whose pockets the cost of the implementing ever more elaborate compliance measures is ultimately drawn. Secondly they reinforce risk-aversion, especially in major financial institutions; as a result they have become steadily more reluctant to take on small-scale customers, and especially those whose background and activities differ from the indigenous norm. Finally the joint effect these developments will inevitably tend to drive 'exceptional' business in this sense towards the periphery of the financial services market, and in doing so reinforce activity in the informal/unregulated sector, where the compliance costs of any given operation will be likely to be dramatically lower. This is precisely the kind of circumstances in which the law of unintended consequences can be expected to have far-reaching effects.

Nevertheless the issues of Drugs Smuggling and Terrorism are matters of intense public concern, there can be no doubt that measures to contain them should remain high on our agenda. However rather than putting all our efforts into what appears to be a largely elusive goal of excluding them from access to of financial service, it would seem far more useful to redirect AML/CFT priorities in a much more specifically forensic direction: towards tracking down, prosecuting and the imprisonment of those actively engaged in planning and

[17] Although the regulations require businesses to submit Suspicious Transaction Reports to remain compliant with AML/CFT, I understand that this has generated such a snowstorm of paper that the exercise is of little if any forensic value.

implementation terrorist activities, and/or the smuggling of narcotic substances. To be sure it may well be the case that following financial footprints left by those perpetrating such activities provides an excellent means of tracking them down; however to allow concern for the tracking operation to override that of reaching the ultimate goal, and then to celebrate the arrest of footprints as an indication that one has fulfilled one's objectives, can only be described as pure folly. So long as surrogates continue to be targeted in this way the only people who have reason to sleep more easily are terrorists and drugs smugglers.

None of this is to decry the prospect that tracking strategies, if properly pursued, might lead investigators to their ultimate goal. On the contrary, maximum advantage should clearly be taken of any opportunity to do so. However this is no sense the priority of the current regulatory approach, nor of the proposals for its reinforcement.

5.5 Fighting terror with error?

Although the precise details of the strategies deployed in pursuit of AML/CFT objectives in the UK differ somewhat from those deployed on the far side of the Atlantic, there are in my view good reasons to suggest that there is much to be gained from comparing and contrasting developments in the two otherwise rather different jurisdictions. With this in mind it its worth paying close attention to Professor Passas' efforts to cast a critical eye over parallel developments in the United States, on the basis of which he has recently published a paper revealingly entitled *Fighting Terror with Error: the counter-productive regulation of Informal Value Transfers.* His conclusions appear to be so closely congruent to my own that I can hardly do better than quote Professor Passas' conclusions at some length.

> The economic and social role of MSBs and remittance providers in particular needs to be emphasized and publicized. Banks could be offered incentives, so that they maintain old and open new accounts for legitimate and compliant MSBs. At the same time, it is essential to define the role of banks with respect to due diligence and risk management, so that it becomes crystal clear that they are indeed not expected in practice to police this financial sector. Along these lines, incentives for high quality and well implemented AML/CFT programs at banks and MSBs would be helpful. Rules must be enforced consistently and through due process. Line agents and examiners need to be made aware of the context and rules as well as other guidance and 'best practice statements issued by their own and related organizations.
>
> Law enforcement actions must be taken on the basis of good evidence that may be produced in a court of law. If the available evidence is not 'actionable' and originates from intelligence gathering methods that cannot be disclosed, the best way forward is to follow the money and monitor suspects and their activities. In this way, controllers will be able to prevent harm and produce evidence against important players and critical nodes of financing systems. All issues raised in this paper (security, due process, rule of law, fairness, economic policy objectives, perception issues, etc.) can thus be addressed in a pragmatic fashion simultaneously. Outreach

> to all stakeholders, seminars and training of agency staff and financial institution officials is vital for the achievement of all these goals as is the independent and critical analysis of available information on terrorist finance, money laundering or other serious crime.
>
> The need to engage in a cost-benefit analysis of current approaches to determine at what point we face an issue of diminishing returns is urgent. Measures deployed originally for the fight against often substantial amounts involved in money laundering have not shown their desired effect on serious crime. Yet, they are hurriedly applied as terrorist financial controls, where the amounts are mostly trivial. Studies illustrate that the currently non-transparent trade, for instance, is extremely vulnerable to abuse for the support of terrorism, arms proliferation, corruption and other serious crimes. It takes well-designed research, solid data and thoughtful analysis to uncover the highest risks, worse threats and top policy priorities.
>
> Fact-free policy making has unsurprisingly failed. It is hoped that the steps recommended here will be followed and will prove instrumental to a more secure, peaceful and prosperous international community. Of course, criminal justice can only address the manifestation of structural and socio-economic problems. For the long-term success of counter-terrorism, addressing the root causes of conflicts at the same time is a *condition sine qua non.*[18]

That there are differences in the way in which the issues have been tackled – or at least perceived – as between the US and the UK is plain to see. Hence whilst American assaults on IVTS networks have overwhelmingly been framed around the prospect that they were, or at least could be used as, channels through which terrorist activities were being financed, in Britain criminal prosecutions directed at Hawala networks have invariably been articulated around suggestions that the funds being transferred were the product of drugs smuggling. However in both contexts little or no concrete evidence was produced to demonstrate that the funds in question were indeed either destined for or the product of the specified activities; and most saliently of all, none of these interventions appear to have provided a means by which the authorities were able to track down and prosecute anyone actively engaged in either terrorism or drugs smuggling. In these circumstances it is hard to avoid the conclusion that by attacking surrogate these convenient surrogate targets the authorities on both sides of the Atlantic have been engaging in what can best be described as a charade, such that they were able successfully to claim that they were making significant progress in their self-proclaimed wars on terror and/or drugs.

None of this is to suggest that the prospect of further terrorist atrocities, let alone on-going flood of narcotics represents as a much of a threat to public security in Western Europe as it

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[18] Nikos Passas "Fighting Terror with Error: the counter-productive regulation of Informal Value Transfers" in *Crime, Law and Social Change*, published on-line by Springer Netherlands on 14th November 2006.

does in North America. Nor is it to deny a further feature of our contemporary situation: that the police and the security services are struggling to find effective responses to a very real threat. The issue here is precisely as Professor Passas puts it: are the AML/CFT strategies which have so far been developed in response to these developments being implemented in such a way as to be fit for purpose? Or are we in the UK making the same mistakes as he suggests are being made in the US, by fighting a war on terror by shooting ourselves in the foot?

Professor Passas' analogy does indeed seem to be entirely apt in a UK context. All serious investigators are agreed that the best way of tracking down criminals and gaining access to the evidence required to bring them to court is by seeking the assistance of the non-criminal members of the community within which the criminals operate, and on whose services those criminals rely as they set about their nefarious business. In these circumstances it makes immediate sense for the authorities to keep a regulatory eye on the services which such criminals might consequently seek to utilise. IVTS/Hawala networks are undoubtedly services of that kind. However the introduction of hostile regulatory initiatives whose most likely effect is either to drive them out of business and/or lead them to conduct their operations underground can in my view be aptly described shooting ourselves in the foot. All remaining prospects of the authorities gaining the confidence of the law-abiding members of the communities within which such malefactors operate will rapidly evaporate, and the prospects of more open communication with the authorities will be further closed down. Osama bin Laden could not have plotted a better outcome if he had done it himself.

Roger Ballard
8th December 2006

Appendix 1: ROGER BALLARD CV

Contact Address: Red Croft, Howard Street, Stalybridge, SK15 3 ER
Phone/Fax 0161-303-1709 Mobile 07843 748 298
email R.Ballard@man.ac.uk URL www.casas.org.uk

1. Qualifications

1966 B.A. in Social Anthropology, University of Cambridge
1970 Ph.D. in Sociology, University of Delhi.

2. Membership of Professional Bodies

Fellow of the Royal Anthropological Institute
Member, Association of Social Anthropologists
Member, Institute of Expert Witnesses

3. Appointments

2002 –	Director, Centre for Applied South Asian Studies, University of Manchester
1989 – 2002	Senior Lecturer in Comparative Religion, University of Manchester
1975 – 1989	Lecturer in Race Relations, University of Leeds.
1971 – 1975	Research Associate, SSRC Research Unit on Ethnic Relations, University of Bristol.

4. Fieldwork Experience

India (District Jullundur):	1967-69 (18 months), 1972-73 (6 months), 1981 (6 weeks), 2000 (3 weeks)
Pakistan (District Mirpur)	1981 (6 weeks), 1984-85 (12 months), 2000 (3 weeks)
Bangladesh (District Sylhet)	2003 (1 week)
UK	Continuous contact (although of varying intensity) with Punjabi communities throughout the Pennine region during the course of the past 20 years

5. Languages spoken

Punjabi, Urdu

6. Research Fellowships and Grants

1996 – 1997	*Reconceptualising race and ethnicity in Britain* Leverhulme Research Fellowship
1999 – 2002	*Kinship, entrepreneurship and the transnational circulation of assets*, supported by ESRC as a component of the Transnational Communities Programme

7. Recent consultancies

2003	*The Current Demographic Characteristics of the South Asian Presence in Britain: an analysis of the results of the 2001 Census* Foreign and Commonwealth Office
2003	*The economic impact of migrant remittances* Department for International Development
1999	Equal Treatment Advisory Committee, Judicial Studies Board (to contribute to second edition of the JSB's *Equal Treatment Benchbook*).

8. Professional activities

In 2003 I took early retirement from my teaching post in the University of Manchester in order to service an ever-growing number commissions to act as a Consultant Anthropologist. In doing so I have accepted instructions from a variety of central and local government agencies, but the bread and butter of my business has turned out to be the preparation of expert reports for use in legal proceedings in which members of Britain's South Asian minorities have found themselves caught up, and in which social, cultural, linguistic, familial and religious issues are in some way at issue. I have now prepared over 300 such reports for use in the criminal, civil, immigration and family courts. Much of the material in my current academic publications is now drawn from my experience of acting as an expert witness.

9. Recent Publications

(in press) “Living with Difference: a forgotten art in urgent need of revival?” in Hinnells, J.R. (ed) *Religious Reconstruction in the South Asian Diasporas: From one generation to another* London: Macmillan Palgrave

2006 “Hawala: criminal haven or vital financial network?” in *Newsletter of the International Institute for Asian Studies*, (October 2006 issue) University of Leiden, The Netherlands p. 8 - 9

2006 “On the consequences of migration below: ethnic colonisation and the dynamics of transnational networks” in *Proceedings of the International Conference on Indian Diasporas* Seoul: Hankook University of Foreign Studies p. 11 – 39.

2006 "Popular Islam in Northern Pakistan and its Reconstruction in Urban Britain" in Hinnells and Malik (eds.) *Sufism in the West* London: Routledge p. 160 – 186.

2006 “Ethnic diversity and the delivery of justice: the challenge of plurality” in Shah, Prakash (ed) *Migrations, Diasporas and Legal Systems in Europe* London: Routledge Cavendish p. 29 – 56

2005 “Migration, Remittances, Economic Growth and Poverty Reduction: reflections on some South Asian developments” in Siddiqui, Tasneem (ed) *Migration and Development: Pro-poor policy choices* Dhaka: The University Press p. 333 - 358

2005 "Coalitions of Reciprocity and the Maintenance of Financial Integrity within Informal Value Transmission Systems: the operational dynamics of contemporary hawala networks" in *Journal of Banking Regulation* Volume 6, 4 pages 319 - 352

2005 "Remittances and Economic Development in India and Pakistan" in Maimbo, S and Ratha, D eds. (2005) *Remittances: Development Impact and Future Prospects* Washington DC: World Bank pages 103 - 118.

2004 “Remittances and Economic Development” in *Migration and Economic Development: How to make development work for poverty reduction* Sixth Report of House of Commons International Development Committee, Session 2003-4 London: The Stationary Office HC-II, Ev 157 - 167

2004 "Delivering migrant remittances: the logistical challenge" in *The Journal of Financial Transformation*, Volume 12, pages 141 - 153.

2003 "A case of capital-rich under-development: The paradoxical consequences of successful transnational entrepreneurship from Mirpur" in *Contributions to Indian sociology* (n.s.) 37, 1&2 pp. 49 - 81, and reprinted in Gardner and Osella (eds.) (2003)*Migration, modernity and social transformation in South Asia*, New Delhi: Sage. pages 25 - 57

2003 "The South Asian Presence in Britain and its Transnational Connections" in Singh, H. and Vertovec, S. (eds) *Culture and Economy in the Indian Diaspora*, London: Routledge Pages 197 - 222

2002 "Race, Culture and Ethnicity" in Holborn, M. (ed) *New Developments in Sociology,* The Causeway Press.

2000 "Religious reconstruction in an alien environment: the Sikh tradition in Britain", in Coward, H. and Hinnells, J.R. (eds), *The South Asian religious diaspora in Britain, Canada and the United States* New York: SUNY Press. pages 193 - 124

2000 "Panth, Kismet, Dharm te Qaum: Four dimensions in Punjabi Religion" in Singh, Pritam and Thandi, Shinder (eds.) *Punjabi Identity in a Global Context* Delhi, Oxford University Press, p 7-37

1999 "Communication" and "Ethnic Minority Families", in *Equal Treatment Benchbook* London, Judicial Studies Board, pp. 87 - 98, and 99 - 115.

Appendix 2: Evidence given to the Select Committee on International Development

Ev 168 International Development Committee: Evidence

Supplementary joint memorandum submitted by Dr Roger Ballard, University of Manchester, and Dr Saad Shire, Dahabshiil Transfer Services

A STRATEGICALLY INFORMED APPROACH TO REGULATORY INITIATIVES FOR IFT/HAWALA SYSTEMS: SOME RECOMMENDATIONS

We would strongly commend the arguments set out in the statement issued at the close of proceedings of the 2nd International Conference on Hawala in Abu Dhabi, and most especially its explicit recognition that informal funds transfer (1FT) systems playa key role in facilitating remittances, and that as such they now form an integral part of the international financial system. More specifically, we would also argue that any planned regulatory regime should recognize that

1. Such systems are not deposit-holding banks: rather they are specialist inter-currency funds transmission agencies, aiming to deliver funds entrusted to them within 24 hours.

2. Regulatory systems will only work effectively if they are designed to fit the specific character of the processes being regulated, and take cognisance of the specific (and varying) socio-cultural character of the customer base in the community which each IFT system serves.

3. Relatively little is known about the varying character of IFT systems in different parts of the globe: our knowledge-base must be improved if effective and appropriate regulatory regimes are to be established.

4. The imposition of inappropriately draconian regulatory regimes will simply drive 1FT yet further underground, so defeating the object of the exercise.

5. In constructing such exercises, the precise objectives of the regulatory structure must be carefully spelled out, and the utility of all proposals must be carefully scrutinised from both a cost/benefit and a fit-for-purpose perspective.

6. The fact that IFT systems frequently transfer funds on behalf of commercial businesses, charities and so forth besides retail customers should not be overlooked.

7. In pursuit of the efficient implementation of long-distance inter-currency value transmissions, IFT systems routinely implement standard forms of banking practice, including the consolidation and deconsolidation of funds in large tranches to facilitate settlement processes. Whilst these processes are the key to the commercial success of IFT, it is at this level that criminally-sourced funds could most easily be slipped into the system. To that extent current know-your-(retail)customer regulations appear to be poorly focused viz to the task in hand.

8. Contemporary IFT systems are in a constant date of development, and many have achieved a higher level of electronic sophistication than the banks; the ever-wider use of advanced technology improves rather than threatens-the prospects for more effective exclusion of criminal malfeasance.

9. Effective regulation is only likely to be achieved in the context of close cooperation with IVT operators: top-down initiatives, especially if draconian in character, are likely to be precipitate counter-productive outcomes.

10. IFT operators should therefore be encouraged:
(i) To publicly identify themselves, preferably in incentivised registration schemes
(ii) To gather themselves together into formally constituted organisations
and with whom the authorities would consequently be able to negotiate on a collective basis

11. Efforts should be made to develop and support (rather than to condemn) the operational and managerial practices currently deployed by IFT operators. Such an initiative could usefully be facilitated by an international or a regional development agency.

12. In the interest of facilitating the further development of legitimate 1FT, greater efforts should be made to harmonise regulations across countries. The mutual recognition of national regulations (eg within the European Union) would simultaneously facilitate growth, greater operational efficiency and the more effective exclusion of potentially criminal transactions.

April 2004
See also the Conference Statement from the Second International Conference on Hawala, available at: http://www.cbuae.gov.ae/Hawala/statement-E.htm