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Concerning the

HAWALA

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First: Hawala definition

An informal remittance system that does not require transferors identity verification, or detecting and reporting suspicious transactions. The transfer of money is carried out through unregulated network with no physical or electronic movement of money. The settlement takes place between the hawaladar (intermediary commander) and the other hawaladar (intermediary receiver) from whom the money is received.

Second: Characteristics of the Hawala

- 1- Anonymity: Hawala hinges on complete secrecy of transactions carried out thereby in terms of content, form and procedure.
- 2- Oral: Transactions are executed orally.
- 3- Trust: Absolute trust among parties is a vital condition for transferring via hawala.

Third: Parties to the Hawala

- A- Transferor: The holder of the money which is being transferred.
- B- Hawaladar (intermediary commander): The service provider who collects the money intended to be transferred in return for a small percentage charge.
- C- Hawaladar (intermediary receiver): The service provider who distributes the value on behalf of the transferee upon the order of the intermediary commander.
- D- Transferee: The receiver of the hawala amount denominated in the agreed-upon currency from the intermediary receiver.

Fourth: Reasons of Prevalence

- 1- The lack of banking and financial services in remote areas which funds are being transferred to.
- 2- High fees and charges of formal transfer through licensed banks and financial institutions in comparison with low fees and charges of informal money transfer. In addition to evading customs, income and consumption taxes and other levies in some countries.
- 3- The speed of transfer through the informal transfer system at times in comparison with the speed via official conducts (licensed banks and financial institutions) and the need for transferring funds outside the official working days.
- 4- Discrepancies between official and unofficial exchange rates at times in favor of transferors.
- 5- Strict monetary restraints in some countries lay on money movement or transfer abroad.
- 6- The largely increasing number of immigrants and/or expatriate workforce, wishing to transfer money to their native countries.
- 7- Incapability to meet the standards of verifying identities of transferors or transferees, and the required measures of due diligence.
- 8- Traditions and social values in many societies which bestowed credibility on these systems.
- 9- Difficulties facing illegal immigrants in opening personal bank accounts at foreign banks.

- 10- Some exporters find themselves compelled - as a result of economic sanctions opposed on some countries- to seek informal transfer systems to get the return for their goods and services.
- 11- Informal transfer systems are used for illegal activities such as money laundering, terrorism financing and tax evasion.

Fifth: Hawala Risks

- The informal remittance system does not require verifying the identity of transferors or detecting and reporting suspicious transactions, in addition to the lack of control or record keeping, transparency and accountability. Since large sums of money are being handed over through this system, there is a potential for misusing it in illegal activities.
- There are many economic impacts on the informal transfer system, either of which those related to the monetary policy and exchange rates, the fiscal policy, or the patterns of consumption and expenditure:

1- Monetary policy and the exchange rate:

Transactions carried out in foreign exchange outside the limits of regulated markets of exchange rates may have adverse effects on the balance between foreign currencies and the national currency, and this can negatively affect investment flows in the national economy and consequently paralyze growth.

2- Fiscal policy:

Informal transfer systems adversely impact macroeconomic fiscal policy. Preliminary, the circulation of these amounts of money outside of the official economic cycle causes losses to the national resources represented by the inability to levy any taxes or duties on those amounts.

3- Expenditure and consumption patterns and wealth drain:

Informal transfer of money leads to paralyzing the authorities' ability to implement macroeconomic policies due to the abating reliability of available economic data and statistics in light of a weak capability to measure and forecast the size of such transactions. These informal transfers cause disruptions to resources and wealth distribution and in the economy, not to mention the chances they open to wealth and capitals drain and smuggling to the outer world without leaving any minor evidence or trace thereon in the country of origin, and that by itself causes severe damage to the national economy.

Sixth:

1- Forty recommendations on Money laundering:

Recommendation (23) implies the following:

"Other financial institutions should be licensed or registered and appropriately regulated, and subject to supervision or oversight for anti-money laundering purposes, having regard to the risk of money laundering or terrorist financing in that sector. At a minimum, businesses providing a service of money or value transfer, or of money or currency changing should

be licensed or registered, and subject to effective systems for monitoring and ensuring compliance with national requirements to combat money laundering and terrorist financing."

2- Nine special recommendations on Terrorist Financing:

The sixth SR prescribes the following:

"Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions."

The focal point of this recommendation consists of the following three core elements:

"a. Jurisdictions should require licensing or registration of persons (natural or legal) that provide money/value transfer services, including through informal systems

b. Jurisdictions should ensure that money/value transmission services, including informal systems are subject to applicable FATF Forty recommendations and the nine SR.

c. Jurisdictions should be able to impose sanctions on money/value transfer services, including informal systems, which operate without a license or registration, make illicit transfers and fail to comply with relevant FATF Recommendations."¹

Seventh: Hawala international conferences

(1) **The First International Conference on Hawala** hosted by the United Arab Emirates in Abu Dhabi on May 15 and 16, 2002 produced at its conclusion the "Abu Dhabi Statement on Hawala" which included the following:

- The word "Hawala" comes originally from the Arabic language and means transfer or remittance, but in this context refers specifically to informal money or value transfer systems or networks outside the formal financial sector.
- The conference participants agreed that hawala and other informal remittance systems have many positive aspects and that most of the activities conducted by hawaladars (Hawala Operators) relate to legitimate business. Hawala provides a fast and cost effective method for worldwide remittance of money or value, particularly for persons who may be outside the reach of the financial sector.
- The participants also raised concerns about hawala and other informal remittance systems, noting that a lack of transparency and accountability, as well as the absence of governmental supervision present a potential for abuse by criminal elements.

¹ Interpretative Note to SR VI: Alternative Remittance: <http://www.fatf-gafi.org/dataoecd/53/34/34262291.PDF>

In light of these concerns, the participants agreed to issue the following recommendations:

- ❖ Countries should adopt the FATF Forty Recommendations on Money Laundering and the Special Recommendations on Terrorist Financing in relation to transferors, including hawaladars and other alternative remittance providers, as well as any other international recommendations or guidance.
- ❖ Countries should designate competent supervisory authorities to monitor and enforce the application of these recommendations to hawaladars and other alternative remittance providers.
- ❖ Regulations should be effective but not overly restrictive.
- ❖ The continued success in strengthening the international financial system and combating money laundering and terrorist financing requires the close support and unwavering commitment of the international community.
- ❖ The international community should remain seized with this issue and should continue to work individually and collectively to regulate the Hawala system and other informal remittance systems for legitimate commerce and to prevent its exploitation or misuse by criminals and others.

- (2) **The Second International Conference on Hawala** was held in Abu Dhabi between April 3, 2004 and April 5, 2004. The final statement of the conference identified the challenges facing the informal remittance systems that are not subject to official regulatory supervision and requested the implementation of the best procedures and practices related to hawala system and other informal remittance systems.

The statement requested also the countries, as a first step, to register and/or license the informal remittance systems. Further anti-money laundering and terrorist financing requirements should then be implemented by countries according to their capacity. The statement encouraged also the Financial Action Task Force (FATF) and the international financial institutions or other international organizations to develop further guidance in this regard.

- (3) **The Third Hawala Conference** was held on April 2 and 3, 2005 in Abu Dhabi. The final statement emphasized on the important achievements that were achieved during the first and second hawala conferences. The conference insisted on the main social and economic roles of the hawala and the other informal remittance systems in facilitating the transfer of funds, especially those of the expatriate workforce. One of the main results of the conference resides in the awareness that it has promoted about the role of informal remittance systems.

The informal remittance systems, in similarity to the other components of the financial system, can be also misused /abused for criminal purposes.

Therefore, it is highly important to increase transparency in this sector and implement procedures to face those risks according to international standards and best practices in this regard, especially SR XI of the FATF.

The conference highlighted the importance of continuing the work in the following fields and undertaking the following:

- ❖ Enhance the exchange of information and international cooperation including mutual legal assistance.
- ❖ Deep understanding of informal remittance systems functioning and how they carry out settlements mainly regarding commercial transactions and cash flows.
- ❖ Ensure that the informal remittance systems can freely have access/use the banking services.
- ❖ Effectively regulate this sector without restricting the free access of hawaladars to the financial services.
- ❖ Train the informal remittance systems intermediaries on the requirements of applicable monitoring systems.

The conference encouraged each country to assess the risks defined in its informal remittance systems to combat money laundering and terrorist financing as well as other crimes.

The conference also encouraged the Financial Action Task Force (FATF) to take into consideration those recommendations when reviewing the international standards.

Eighth: Best Measures applied in regulating alternative remittance service:

1- Registration/licensing:

- The informal transfer service is to be registered or licensed. Transferring service providers' registration shall be confirmed at a competent regulatory authority such as the Financial Intelligence Unit or the financial sector regulatory agency. Registration is relatively less costly than licensing.

2- Enhancing awareness and recognition:

a- Recognition strategies:

- Observation and watching various mass media to find advertisements relating to informal transfer service providers in order to reach and inform them of the necessity of registration or licensing.
- Attention should be paid to the fact that money transfer services are usually used when large amounts of money are being transferred, especially when money smugglers are involved; informal money transfer providers can be traced by pinpointing those smugglers.
- Attention should be paid especially to reports about suspicious and unusual local operations, as well as all to local or international reports indicating large movement of money, which in turn can help reveal a potential link with informal transfer services.

b- Awareness enhancing campaigns:

- Informal transfer service providers should receive awareness training and compliance-oriented programs which may include on-site visits to agencies probably providing informal transfer services in order to advise them on the necessity of registration or licensing and reporting.

- Potential clients should be informed about the risks they take when using informal transfer services and on the role these services play in terrorist financing and money laundering.
- Agencies providing transfer services should be asked to present their licenses or registration documents to their clients; it has to be noted that legal dealers usually prefer to have their transaction done through formal service providers.
- A list of registered/licensed agencies and people providing money transfer service should be prepared and made available to the public.
- Law enforcers should be aware of compliance requirements relating to money transfer and of the procedures used for illegal purposes.

3- AML instructions:

- Instructions monitoring money transfer services should not be overly restrictive in order not to constitute a burden on transfer intermediaries and to compel them to have recourse to hidden informal transfer systems where it becomes difficult to trace money laundering and terrorist financing transaction. This instruction should be able to help detecting people who misuse money transfer systems. Such measure should be accomplished through:

a- Customer due diligence:

- According to the recommendation 5 of the forty recommendations, money transfer service providers should complete all information necessary to identify the customer and to verify customer's identity such as passports, identity cards, driving licenses or similar documents. It is important to refuse carrying out the transfer when the service provider is unable to complete this kind of information. The provider must also report any suspicious transaction, knowing that such measures constitute a minimum level of CDD.
- Conducting transactions by telephone, fax, or via internet can be done only after having verified the customer identity as aforementioned, otherwise the transaction must not be executed.

b- Record-keeping:

- Money transfer service providers should keep records enabling investigation agencies to trace transactions and identify their conductors so that these agencies can proceed to investigate money laundering and terrorist financing activities. However a certain balance must be preserved between the burden of record-keeping and the needs of regulatory agencies for information and records.
- Countries should take due measures to compel financial institutions, including providers of money transfer services, to provide accurate information about the transferor (name, address, account number) and any related letters and documents when carrying out a transfer. This information should be maintained at all stages of the payment process.

- Money transfer service providers should keep records of all transactions, domestic or international, for five years at least. Basic requirements as to the form of such records should be defined.

c- Reporting suspicious transactions:

The obligation of reporting suspicious transactions imposed on service providers must be in conformity with obligations imposed on banking and financial institutions in this regard, taking into consideration the definition and characteristics of suspicious transactions as specified in the special guide set out by regulatory agencies.

4- Compliance monitoring:

Regulatory agencies must monitor money transfer services and define informal service providers and cases in which criminals and terrorist groups use these services. Countries may apply one of the following options:

- 1- Competent authorities must be authorized to audit unregistered agencies suspected of being involved in money transfer services.
- 2- Regulatory agencies and supervisory authorities shall be given the auditing authority on licensed and registered money transfer services, and the right of paying sudden visits to money transferring service providers in a way that enables them to audit details of registers and inspection records. In the latter case, due care should be given to the requirements of keeping records.

Ninth: Experience and systems of MENAFATF countries:

Hawaladar registration and reporting system applicable in the United Arab Emirates.

In light of the Hawala international conference held in May 2002 and Abu Dhabi statement on Hawala, the UAE Central Bank issued and published in the press a regulation for licensing hawaladars and supervising their activities, inviting them to register with the Central Bank and to obtain a free certificate, requesting hawaladars to provide the Central Bank with details about the transferors and transferees in a form prepared for that purpose. They were also requested to submit reports about suspicious transfers to the anti-money laundering and suspicious cases unit at the Central Bank.

The Central Bank promulgated the regulation about registration and reporting systems of Hawaladars on April 1, 2003.

Main characteristics of the Hawaladar registration and reporting regulation:

- The system has been made simple for registration and reporting and not overly restrictive.
- The UAE Central Bank confirmed to all hawaladars that their names and statements relating to their activities shall be kept confidential at the Central Bank and shall not be disclosed to external parties in their countries.

- International recommendations about money transfer, mainly the FATF Forty recommendations on money laundering and the nine SR on terrorist financing have been taken into consideration.
- The Central Bank will hold meeting with hawaladars with the aim of informing them about the right enforcement of the system, the required transparency in the statements and the reporting of suspicious transactions.
- The main purpose of the hawaladars registration and reporting regulation is to protect the hawala system from being exploited or misused by money launderers or terrorist financiers.
- This regulation was set on basis of the conviction that the hawala system is crucial to deal with money remittances of the low-income illiterate migrant workers who transfer their small remittances to remote regions in their countries of origin where official exchange and formal bank services do not exist.

Registration procedure

1- Registration application:

The hawaladar must submit a registration application to the UAE Central Bank using the application form made for that purpose and including the following information:

- Full name (as it appears on the passport)
- Nationality
- Type of work carried out in the country
- Nature of the job
- Age
- Full address
- Phone and fax numbers
- A certified copy of the passport and the commercial or professional certificate along with a photograph of the hawaladar or his associates shall be enclosed with the application form.

2- Registration certificate

After having considered the application and met the applicant in his capacity as hawaladar and discussed with him and informed him about the applicable laws in the United Arab Emirates relative to combating money laundering and terrorist financing and the regulations and procedures applicable in this regard, the Central Bank shall issue a registration certificate that shall include basic information about the hawaladar, the activity he is authorized to perform, a provision prohibiting him from exercising currency trading and exchange activities, and stating that he must abide by applicable laws in the country.

Periodic reports to the Central Bank

Hawaladars must provide the UAE Central Bank regularly (monthly/quarterly) with the following details:

a) Transfer orders report

The report shall include the following data in addition to the name of the hawaladar:

- Name of transferor
- Place of work of transferor
- Nationality
- Passport number
- Amount transferred
- Name of transferee
- Country of destination
- Purpose of the transfer

b) Inbound transfers report

The report shall include the following information in addition to the name of the hawaladar:

- Name of transferee
- Place of work of transferee
- Nationality
- Transferee's passport number
- Amount transferred
- Name of transferor
- Country of origin
- Purpose of the transfer

Reporting suspicious transactions

In case the hawaladar has suspicions about any ordered or received remittances, he must notify the anti-money laundering and suspicious cases unit at the Central Bank with the report of the suspected case. The suspected case report shall include the following:

- Information about the hawaladar, full name, passport number and/or license details and nationality.
- Details about the suspected case:
 - Name and address of the transferor
 - Name and address of the transferee
 - Amount transferred
 - Nature of transfer: ordered or received
 - Countries of origin and destination
 - Detailed reasons for suspicion
 - Hawaladar signature and date

Tenth: Recommendations

- 1- Countries should adopt the FATF Forty recommendations on money laundering and the nine special recommendations on terrorist financing related to money transfer service providers, and any similar international recommendations and directives.
- 2- Countries should assign a competent regulatory authority entrusted with monitoring and imposing these recommendations on hawala intermediaries and other informal money transfer system providers.
- 3- Organizing awareness campaigns for the citizens and expatriate nationals of concerned countries and resident foreigners about the risks of dealing with informal money transfer systems, urging them to channel their transfers via official systems.
- 4- Organizing awareness campaigns for money transfer service providers in the field of AML/CTF.
- 5- Training and Typologies Working Group of MENAFATF shall analyze some actual cases through the TTWG's suggested operation mechanisms to unearth methods and trends which might be applied and adopted by money launderers and terrorisms financiers.
- 6- Regulation and control over money transfer service providers shall not be exaggerated lest that cause informal money transfer operations to expand and be carried out in secret.
- 7- The international community shall have continuous interest in this situation. Similarly, it should go on individual and collective work to reset informal money transfer systems towards legal business ends, to avoid misuse thereof by criminals and the like, and to encourage countries to assess risks associated with their sectors of informal transfer systems so that they can confront money laundering and terrorist financing and similar crimes.
- 8- Countries shall try to organize the business of hawala by encouraging service providers to have themselves registered or licensed, so that registration can be deemed a half way process towards full licensing while observing the specificities of each country.
- 9- Enact legislations which regulate the hawala service, imposing relevant sanctions on uncommitted hawala service providers and those involved in money laundering and terrorist financing activities.
- 10- Promoting information exchange and international cooperation.
