Informal payments, crime control and fragile communities

Nikos Passas
Northeastern University
Background and three main points

• “Recently cash has become unpopular in political circles, as it effectively restricts states’ power to tax (explicitly or via negative interest rates) or to survey and potentially control their citizens. Several states have enacted restrictions to the use of hard cash.”

• De-risking and avoidance of informal remittance companies. Is switching out of cash for better risk management and control?

• Are most damaging crimes and risks in cash?
• Regulatory arrangements unsatisfactory
• Useful means to monitor and help develop economies and fragile states
NO CASH SCANDALS AND RISKS

- DEUTSCHE BANK
- BNP PARIBAS
- HSBC
- JPMORGAN CHASE
- CITIGROUP
- LLOYDS BANKING GROUP
- MADOFF INVESTMENT SCANDAL
- LIBOR
- FINANCIAL CRISIS
- BANK OF NEW YORK
- 9/11
- S&Ls in the USA, BCCI, PPI, AMBROSIANO, KP, RM, R, ETC
- “ODIOUS DEBT”, GS AND EUROZONE
LIBOR
JPMORGAN CHASE

YOUR BOARD OF DIRECTORS PROUDLY ANNOUNCES...

...AN ELEVENTH CONSECUTIVE QUARTER...

...OF AVOIDING PRISON

WELCOME, SHAREHOLDERS
MADOFF INVESTMENT SCANDAL
MADOFF INVESTMENT SCANDAL
WELL, THERE GOES THE NEIGHBORHOOD...

FINANCIAL CRISIS
FINANCIAL CRISIS

Question: Who was responsible for the financial crisis?
• Distrust of government and banks in recent times – capital controls and bail ins reminiscent of older scandals around the world
• 85% in cash and 2.5 billion w/out account – reduce cash by turning clients away from banks? migrants banked in EU now?
• De-risking and humanitarian law violations: communities starved, countries left out, capital drained out of entire economies, development and global growth undermined
Fighting terror with error

- Informal remittance channels furnish vital service but also facilitate serious crime, not unlike banks and other formal financial service providers.
- Regulation inconsistent, misapplied, mis-measured, ineffective, costly, counter-productive
- Policies formed with imperfect knowledge of sectors and networks subject to regulation, independently of industry/community views, and without coordination at national and international levels.
- Regulation necessary but proportionate to the risk and appropriate to socio-economic and cultural environments.
De-risking and risk growth

• eliminate company risk for individual financial institutions
• increase the systemic risks and create additional externalities.
• Displacement to channels harder to monitor.
• Billions of legitimate flows unduly criminalized or treated as suspicious.
• Raise the cost of sending money to the very people who need more options and lower costs for remittance services.
• needy communities and families suffer, may be unable to survive in challenging and conflict-ridden contexts. Development projects and economic growth undermined by lack of liquidity and investment with dire effects on the banking and other industries.
• Anti-West sentiment, radicalization and violent conflict as well as additional pressures to migrate to Europe or OECD countries in search of economic and security shelter
• The entire humanitarian community in Somalia relies on the availability of MSBs to do business including transferring funds for project activities to organization staff or local partners and paying for staff and office running costs.

• Without MSBs, the UN and NGOs in Somalia would be forced to carry cash to pay day-to-day operational and program costs, placing funds and staff at risk in an insecure environment.
• 51 percent are women - remittances account for 64 percent of their income
• A large majority employed, particularly in such professions as teaching and entrepreneurship
• Remittances account for 60 percent of their average annual incomes of $3,000
• The average cost of sending $200 to Somalia is $10
• 5 percent falls below the 9 percent average cost of sending remittances globally and well below the 12 percent average cost of remitting to Africa (WB 2013)
• Somali-American remittance companies often also provide unofficial checking “accounts”...but the funds are not insured
Figure 11 Average cost by product type
Comparative amounts received in Pakistan for 100 USD from Dubai

<table>
<thead>
<tr>
<th>Method of remittance</th>
<th>Charges</th>
<th>Total paid</th>
<th>PK Rupees received</th>
</tr>
</thead>
<tbody>
<tr>
<td>Draft (exchange house)</td>
<td>1.36 - 2.722</td>
<td>101.36 - 102.722</td>
<td>5901 – 5910</td>
</tr>
<tr>
<td>Draft (Bank)</td>
<td>2.722 - 6.80</td>
<td>102.722 - 106.80</td>
<td>5890</td>
</tr>
<tr>
<td>TT (exchange house)</td>
<td>9.52 - 16.33</td>
<td>109.52 - 116.33</td>
<td>5901 – 5910</td>
</tr>
<tr>
<td>TT (Bank)</td>
<td>12.25 - 27.22</td>
<td>112.25 - 127.22</td>
<td>5890</td>
</tr>
<tr>
<td>Western Union</td>
<td>9.52</td>
<td>109.52</td>
<td>5858</td>
</tr>
<tr>
<td>Hawala</td>
<td>NIL</td>
<td>100</td>
<td>5920</td>
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</table>
## Legal Status of IFTS (FATF 2013)

### Table 3.1 Legal Status of Hawala and Other Similar Service Providers

<table>
<thead>
<tr>
<th></th>
<th>Illegal</th>
<th>Legal</th>
<th>Total</th>
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<tr>
<td><strong>Number of Countries</strong></td>
<td>18</td>
<td>15</td>
<td>33</td>
</tr>
<tr>
<td>of which Developed Country</td>
<td>6</td>
<td>11</td>
<td>17</td>
</tr>
<tr>
<td>of which Developing Country</td>
<td>12</td>
<td>4</td>
<td>16</td>
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</table>
USA Federal regime

- Registration
- Record Keeping
- Reporting Suspicious Transactions
- KYC
- AML procedures even for unregistered agents
US States

• Licensing
• Bond, capitalization, net worth, fees
• Non-pragmatic and unaffordable patchwork of rules
<table>
<thead>
<tr>
<th>State</th>
<th>Net worth</th>
<th>Bond</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>min $ 500,000 in equity</td>
<td>Determined by Commissioner</td>
<td>$ 5,000 plus $50 per agent</td>
</tr>
<tr>
<td>Florida</td>
<td>min. 100,000 plus $ 50,000 per location in FL up to $ 500,000 - may be waived upon request</td>
<td>Set by commission rule – max. $ 250,000 – up to $500,000 in exceptional circumstances - may be waived upon request</td>
<td>Appl.: $500 plus $50 per agent; renewal $1000 $50 per agent up to $20,000</td>
</tr>
<tr>
<td>New Jersey</td>
<td>(1) min. $100,000 plus $25,000 per location or agent in NJ up to $1,000,000. (2) $50,000 for foreign money transmitter plus $10,000 per location or agent up to $400,000</td>
<td>(1) min $100,000 up to $1,000,000 (2) foreign remitters: depending on volume $25,000-$100,000 - commissioner may require up to $900,000</td>
<td>Appl.: $1,000 Lic.: up to $4,000 Biannual fee $25 per location up to $5,000</td>
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<tr>
<td>New York</td>
<td>Investments equivalent to outstanding payments</td>
<td>Min. $ 500,000, unless superintendent determines lower amount suffices</td>
<td>$ 500 annual + $1,000 investig.</td>
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<tr>
<td>Illinois</td>
<td>$35,000-$500,000 depending on number of locations</td>
<td>Min. $100,000 or average daily outstanding for 12 months - max. $2,000,000</td>
<td>$100 appl. $100 license $10 per/l – ren. $100- $10 p/l</td>
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<td>Pennsylvania</td>
<td>$500,000</td>
<td>$1,000,000</td>
<td>Appl. $ 1,000, renewal $300</td>
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<tr>
<td>Texas</td>
<td>$25,000 per location up to $1,000,000</td>
<td>Min. $300,000 determined by commissioner $ 100,000 for first location, $ 50,000 for each additional up to $ 400,000</td>
<td>Appl./lic., invest. and renewal [$500 licensing + $2,500 invest.]</td>
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<tr>
<td>Virginia</td>
<td>$100,000-1,000,000 as determined by the Commission</td>
<td>$25,000-1,000,000 as determined by the Commission</td>
<td>License $ 500, renewal $2750</td>
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Lawful but awful: Account Closings

- OCC advisory
- Examiners’ practice
- Bank initiative
- 100s of legitimate accounts closed
- Underserved and undeserved: Private industry end up deciding who would get indispensable services and who would not
- Risk-based? Sunrise, Barclays, etc.
August 16, 2012

RE: [Redacted] Your Deposit Account Relationship with [Redacted]

Dear [Redacted],

We have recently completed a review of your account and determined we are unable to continue our banking relationship with you. We acknowledge that you have banked with us for a number of years, however, trends in the regulatory environment and changes in our Bank’s policies require that we discontinue your relationship.

In order to provide time for you to relocate your accounts, we are not closing them immediately. Instead, we would ask that your accounts be closed no later than SEPTEMBER 20, 2012. Any collected funds remaining in your accounts on SEPTEMBER 20, 2012, will be sent to you at the address we have on file for mailing account statements and notices, via the United States Postal Service in the form of a cashier’s check. No deposits or withdrawals will be processed beginning on this date.

Our goal is to assist you in the orderly closure of your accounts and would ask that you call me with any questions that you may have in this process. I can be reached at [Redacted]

Sincerely,

[Redacted]
August 1, 2012

Reference # [REDACTED]

Dear Business owner:

Thank you for your business checking or savings account application. The Office of the Comptroller of the Currency (OCC) has issued guidance regarding factors that a national bank should consider when evaluating a new account request for a Money Services Business. Our analysis of the information received leads us to conclude that your business did not fall within the acceptable risk parameters of our Money Services Business Program as a result of at least one of the following:

- Your company did not meet our requirements in our business due diligence background investigation.
- [REDACTED] determined that your account(s) create an unacceptable level of risk for the bank.
- The [REDACTED] Money Services Business Due Diligence Unit did not receive requested information by the required date.

This letter confirms that your account application is declined.

Again, thank you for your interest in doing business with [REDACTED].

Thank you,

[REDACTED]
Impact

• “For them, it’s small potatoes, but for us, it’s how we feed our families”
• More conflict and radicalism
• Lower capacity to monitor illicit flows
Basic Hawala

Marwan
USA

Amjad
Pakistan

Hawaladar
in USA

Hawaladar
in Pakistan
Beneficiaries

Senders

Cash Pool

A

Communication
Via FAX, TEL, EMAIL

Cash Pool

B

Beneficiaries

Senders
Example of fax record keeping

F.A.O. GURU              22/05/01                 PAGE 1

492 SENDER : - HARJIT SINGH RECEIVER : - R.K. GUPTA W / O SANJOY SINGH
128/6 PREET NAGAR LADOWALI ROAD JULLUNDHUR TEL : - 181 12345
DISTT. JULLUNDHUR 1400//=

493 SENDER : - JOHANDER PARTHA RECEIVER : - BHAGWANT SHARMA WIFE OF
LATE SEN SINGH SON JOGINDER SINGH HOUSE NEAR THE GURUDWARA
VILLAGE DALEWAL P.O. GORAYAN TEL : - 1826 12345 DISTT.
JULLUNDHUR 1000//=

494 SENDER : - KANG RECEIVER : - ARJINDER SINGH DEFENCE COLONY MOBILE
NO.98141-12345 OR 981 55 123456 JULLUNDHUR
18000//= TOKEN NO. 4AS 689122 (50 INR)

URGENT MESSAGE

THE ORDER NO 494 ABOVE
MUST BE DELIVERED BY WEDNESDAY 23RD MAY
2001 OR THE LATEST 24TH MAY 2001 IT IS
EXTREMELY URGENT
DATE : -07/04/01
DEAR MOHAMAD XXX JI
SEN GUPTA
WOULD YOU KINDLY DELIVER THE ORDER BELOW AS SOON AS POSSIBLE :

PUNJAAB
450 SENDER : - LALA RECEIVER : -BABA SINGH OR DAUGHTER SINGH
V.P.O.SHAHCOTE TEL:- 123474430/ 12352 / 12347
TOKEN NO. 90H707111(10 INR) 950000 ( NINE LACS FIFTY THOUSAND INR)
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</table>

1997
TOTAL == 54812.42 80000 3456000 86943.4 -6943.4
Various levels of hawala

USD

C

B

Pounds

Account 1
NYC

Account 2
Dubai

Account 3
Hong Kong

D

D

D
Under Invoicing

Value goes from London to South Asia
SA sends B $150,000 and receives invoice
Under Invoicing

for $250,000 worth of computer hardware, which balances B’s $100,000 debt to SA
Basic Mechanics of IVTS

1. **A** - **X** [physical transport; in-kind payment; pre-paid tel. cards and stored value]

2. **A** - **B** - **X** [courier, epayment, credit and debit card use]

3. **A** - **B** - **C** - **X** [hawala and other trad. IVTS; Wire remitters; in-kind payment; gifts and vouchers]

4. **A** - **B** - **C** - **D** - **X** [trade diversion; correspondent banking; mixed IVTS, including sophisticated hawa]
Risks to consider

- Thoughtless global regulation (forced cosmopolitanism, “derisking” and legal transplants) → paper compliance → loss of control (reinforced parochialism)
- Traceability v. transparency
- Legitimacy v. legality disparities grow – no sustainability
  - Lawful but awful practices
  - Unlawful but useful practices