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NOTE

From:	Austrian Delegation and Europol
To:	Standing Committee on Operational Cooperation on Internal Security
Subject:	The role of criminal “Hawala” and other similar service providers (HOSSPs) in illegal immigration, money laundering and terrorism financing – recommendations for changes and other initiatives

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Introduction

Today it is commonly agreed that money laundering is a threat for our societies because it enables criminal organisations as well as terrorists to successfully hide and convert their ill-gotten gains, leading to reinvestment into further criminal activity, fuelling the growth of organised and serious international crime.

Global Anti-Money Laundering policies have resulted in the European Union in robust legislation, including highly sophisticated compliance regulations, which aim at preventing businesses from being exploited by money launderers. As it gets more and more difficult to place criminal funds in well regulated businesses such as the financial industry, other escape routes, like cross border cash smuggling or money laundering via so called **Informal Value Transfer Systems (IVTS)** are rapidly gaining in importance.

The purpose of this document is to raise awareness of the dangers arising from an increasing use of unregulated IVTS like “**Hawala**” to launder criminal funds and to present a number of recommendations to policy makers on how to address this rapidly emerging threat.

BACKGROUND

What is “Hawala”?

Hawala is a system of money transmission, often reliant on ties within specific geographical regions or ethnic communities, which arrange the transfer and receipt of funds or equivalent value. These movements of value may be settled through trade or cash businesses engaged in remittance activities. They often operate in areas of expatriate communities. Hawaladars (those that operate ‘Hawala’) often run parallel businesses other than money transfer, particularly currency exchange, travel agencies or telephone shops. The term ‘Hawala’ is often used to describe a number of different Informal Value Transfer Systems which have similar properties and operate in similar ways, although they are not strictly ‘Hawala’. Accordingly, in 2013, the Financial Action Task Force (FATF) came up with the wider term ‘Hawala and Other Similar Service Providers’ or HOSSPs to describe this activity. HOSSPs are a subset of informal value transfer services (IVTS)¹²; other forms, apart from Hawala, include Hundi, Chinese underground banking and Black Market Peso Exchange. IVTS is concerned with the **movement of value without the need for money to be physically or electronically moved**.

Despite the possibility of Hawalas to be registered and properly licenced under the Payment Services Directive, Hawaladars choose to carry out such transfers outside of the conventional banking system and without proper licensing, with the consequence that they are then not subject to anti-money laundering regulations or due diligence practices. The implementation of stricter anti-money laundering regulations in mainstream financial institutions has made IVTS increasingly attractive to organised crime groups (OCGs). Members of the diaspora and migrant communities use HOSSPs extensively to send legitimate remittances to their country of origin. However, IVTS is also frequently used by criminal groups for illegitimate remittances, i.e. to transfer large amounts of criminal proceeds or to launder such criminal proceeds, providing layering and remittance services within and outside the EU.³ HOSSPs in the majority of EU Member States are a **“tolerated business”, lacking supervision**.

¹ Criminal Hawala, Uncovering Underground Banking Activities in Europe, Europol Intelligence Notification, March 2017

² FATF Report, The role of Hawala and other similar service providers in money laundering and terrorism

³ SOCTA 2017, restricted version, p. 23

Three major types of IVTS have been historically identified:

- a) The legitimate - popular because of familial, regional or tribal affiliation and inadequate access to regulated financial services for senders/recipients in origin/receiver countries.
- b) The hybrid - also serving legitimate customers, but at the same time being used, wittingly or not, for illegitimate purposes to transfer criminal funds cross-border or to carry out money laundering.
- c) And the criminal - a service purely set up or expanded to service criminals.

Why do we consider HOSSPs to be different from normal remittance systems?

Unregulated HOSSPs provide OCGs with the ability to transfer value (particularly cash) anywhere in the world quickly, cheaply and anonymously.

Contrary to all other remittance systems this one is based on a network of key players (Hawaladars) tied by trust (due to specific geographic regions, families, tribes, ethnic communities, nationalities, commercial activity, etc). Hawaladars compensate between themselves over a long period of time by net settlement using banking channels, trade or cash. This means that contrary to all other remittance systems, no funds are transferred for each and every transaction, but on a daily basis, they use a local cash pool with money that was already in the system to pay the beneficiary. After a set period of time (usually after 2-3 months) only the net amount is settled. Hawaladars aggregate months of funds received through individual remitters and then perform the settlement. (It needs to be stressed that legitimate and licenced value transfer services also usually operate in this way).

Also, within the Hawala network unique techniques are used:

- Bilateral settlement, the “reverse hawala” between two Hawaladars.
- Multilateral settlement, “triangular”, “quadrangular” or other between several Hawaladars part of the same network.

- Value settlement through trade transactions, usually applying Trade Based Money Laundering (TBML) techniques (shipment of the equivalent value through trade transactions, such as merchandise or other commodities such as paying a debt or invoice of same value that they owe, over or under invoicing, double invoicing, Black Market Peso Exchange, etc.).
- Settlement through cash via cross-border cash couriers, banking and Money Service Business (MSB) channels.

Particular Hawala networks are created to serve exclusively criminal needs, by placing and layering criminal money and paying the equivalent value on demand elsewhere in the world. They are known to use the techniques described above. In addition, to protect themselves they use these particular measures:

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All these techniques are unique to the Hawala system and are all known red flag indicators of Hawala activities for EU Law Enforcement Agencies (LEA).

Such particular Hawala networks, the 'Criminal Hawala', also follow a particular structure, composed of:

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Based on the findings of criminal investigations throughout Europe (some case examples below), Hawala is a category of financial services or remittance under Money or Value Transfer Service (MVTs). In case of non-compliance with the regulatory requirements applicable to MVTs (laid out in the Anti-Money Laundering Directives and the Payment Services Directive), Hawala activity should be considered illegal. It is important that Hawaladars are encouraged to register as such and to clearly understand their obligations.

Simultaneously, supervisory authorities should monitor these activities for any signs of informal financial services outside of current regulations.

Moreover, the practice of unregulated Hawala should form a EU criminal offence – to give LEAs the possibility to pursue Hawaladars for providing unlicensed services in order to provide the legal ground for the immediate seizure of all located assets (usually in cash – frequently millions of EUR).

What is the threat?

The scale of Hawala in the EU is unknown.

We know it to be associated to certain businesses (Travel agencies, pawn shops, mobile phone and SIM cards sales, top-up of mobile cards, grocery stores, import/export business and various neighbourhood type of businesses such as nail salons, hairdressers, beauty salons, flower shops) of certain ethnic communities (India, Afghanistan, Pakistan, Iran, United Arab Emirates, Somalia and China) that are common in the EU.

Europol is also aware of several multi-million EUR on-going money laundering investigations focusing on criminal Hawala (see examples below).

There are no direct money/value flows between sender and receiver that LEAs can track or trace. Thus tracing the money/value flow in a Hawala network is virtually impossible even if ledgers are seized – they are usually encrypted and more and more located on cloud servers located in non-cooperative jurisdictions.

What is the vulnerability?

Hawaladars operate outside the legal and regulatory framework and do not register under the Payment Services Directive, as they should.

Authorities are dependent on the conscience, registration or licence, organization and willingness to cooperate of the Hawaladar.

Practice demonstrates that Hawaladars do not consider themselves as obliged entities and that they see themselves transacting as private persons and not as regulated legal entities.

From a financial perspective such Informal Value Transfer – IVT (HOSSPs) are to be considered as Money Value Transfer Systems (MVTs) under the obligation to either register or licence.

Case examples:

The investigations described below have uncovered the use of Hawala for laundering criminal proceeds. All of these investigations have collected strong evidence that proves how Hawaladars operate within the EU and beyond, providing unregulated financial and compensation services in order to legalize criminal funds for their clients as well as performing the already described multiple types of financial operations in order to obscure the origin, the actual holder or the destination of the funds.

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How has it been addressed?

Bearing in mind the rising impact of HOSSP (Hawala and other similar service providers) on criminal proceeds linked to Illegal Immigration, Austria requested funds under the so called “1st Mini-Call” of the EU Policy Cycle Operational Action Plan for Facilitated Illegal Immigration 2016.

The purpose was twofold:

- a) To raise political awareness and provide recommendations for legislative changes from the law enforcement perspective. This is done with the present note.
- b) To produce guidelines for investigators to facilitate successful financial investigations on HOSSPs.

Working method

Austria for this work is supported by the following Member States: Belgium, Germany, France, Netherlands, Spain, United Kingdom and because of the specific experience, Australia is also participating in an advisory role.

Support is provided by Europol (with its European Migrant Smuggling Centre (EMSC) and the Analysis Project SUSTRANS). The above mentioned countries provided experts for a working group to deeper analyse the HOSSP Business Model and develop recommendations and operational guidelines. The group depicted the Hawala Business Model by using Business Analysis Tools used in the private sector. In conducting this analysis, the group concentrated on illegal HOSSP activity and not legally operating HOSSP activity.

With this work the group actively provides results falling under the “Council Conclusions and Action Plan on the way forward with regard to financial investigations”⁴

⁴ 10125/16

Recommendations

1. Strategic goals:

- a. A relentless disruption of criminal business by abolishing the need to prove a predicate offence and follow a “grab the cash” strategy would be a major change. The EU Policy Cycle 2018-2021 now provides a window of opportunity to follow such a strategy with its horizontal priority ‘Criminal Finances and MLAR’
- b. Intensify the working relationships with the United Arab Emirates. Dubai, like London, is a key financial sector and as such is targeted by launderers. Added to that, Dubai is attractive due to the historical and cultural links with a lot of the laundering organised crime groups.
- c. Systematically targeting HOSSPs - more criminal networks and their flow of money will be detected e.g. drug trafficking, smuggling, illegal immigration, Trafficking in Human Beings, labour and sexual exploitation, counterfeit goods, fraud and tax evasion.

2. **Implement the recommendations included in the Supranational Risk Assessment⁵ to the 4th Anti Money Laundering Directive⁶**

HOSSPs are considered as a subset of MVTs (as in the FATF definition)⁷ and in essence are an obliged entity regulated under the 4th Anti-Money Laundering directive and regulated by the Payment Services Directive. The supranational risk assessment now specifically outlines the risks related to MVTs (e.g. money remittances) and provides recommendations to Member States.

⁵ Report from the Commission to the European Parliament and the Council on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating relating to cross-border activities {SWD(2017) 241 final}, 26th June 2017.

⁶ Directive (EU) 2015/849 of the European Parliament and of the Council of 20th May 2015 on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing, amending Regulation (EU) No 468/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC

⁷ FATF Report on "The Role of Hawala and Other Similar Service Providers in Money Laundering and Terrorist Financing, October 2013, page 12

HOSSP activity is a remittance system (Money and Value Transfer System). It provides money or value transfer services to its clients. In its essence it is a financial service and the efforts of the European MS in AML/CTF are moving towards regulation and obligation of every entity providing such services or any system that may imitate and/or resemble them. The practice shows that the list of reporting entities is constantly growing based on identified and emerging threats. This is done in order to prevent criminals from gaining access to the financial system through intermediaries and using them for laundering purposes or taking themselves control of such service providers and abusing them for the same purpose. Moreover, recent and significant law enforcement efforts have proved beyond any doubt that the unregulated and clandestine nature of HOSSP informal remittance systems has made them the preferred choice of criminals in money laundering. Organized criminal groups involved in a broad scope of illegal activities like drug trafficking, smuggling, THB and illegal immigration, tax evasion and fraud are taking their illicit funds to the HOSSP operators. The current state of play without HOSSPs being considered as obliged to comply with regulations subjected to other MVTs in many Member States means that they perform services much similar or even on a larger and more active scale than money service businesses, but contrary to the latter have no obligation to perform customer due diligence (CDD), record keeping and reporting suspicious transactions. Furthermore, because of the benefits of the system, citizens transferring legitimately obtained funds face being criminalised by using the system. This and the informal compensation based principle g between HOSSP operators in different jurisdictions without the need to physically transfer funds, allows the system to operate under the radar of the authorities. Regulating the informal remittance system will bring the following three significant benefits –

- it would bring transparency to the system,
- it would allow legitimized financial inclusion to groups and countries where migrants are repatriating funds without the abuse of the criminal sector and most importantly –
- it would diminish the attractiveness of the informal remittance system to the criminals seeking to move illicit funds.

3. Ensuring that HOSSPs apply correctly the requirements of the Payment Services Directive⁸

In the transposition process, which needs to be completed by 13th January 2018, Member States should ensure that HOSSPs correctly implement the requirements of the Directive applicable to MVTs. HOSSPs activities would then require authorisation. Such correct application would imply at the same time the fulfilment of the AML/CFT obligations under the 4th Anti Money Laundering Directive.

HOSSP activities without authorisation would be an administrative offence. This recommendation could still be implemented during the transposition period.

This would allow for greater transparency of the sector and would improve the monitoring. The transposition process of the PSD 2 Directive could constitute an opportunity to raise awareness of competent authorities and of the representatives of the sector on the requirements they should fulfilled to be in line with the relevant EU framework.

In case of need further options should be explored, such as the organisation of awareness raising sessions on obligations to be applied by the sector.

4. Limit cash transactions in the EU and the obligation to declare cash entering or leaving the EU

Uniform cash transaction limits should be introduced across the EU in order to restrict the use of cash. A threshold should be introduced, e.g. 10,000 EUR. This would place an upper limit on the use of cash as payment settlement instrument.

At the same time, this limit is compatible with the declaration threshold proposed for cash that enters the Union, based on the Commission proposal on controls on cash entering or leaving the Union (2016/0413 (COD)). Cash declaration data is made available by competent authorities who enforce the obligation to declare to FIUs, who can analyse these declarations and integrate them with other available data and who are empowered to notify relevant authorities for further investigation.

⁸ Directive (EU) 2015/2366 of the European Parliament and of the Council of 25th November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC

5. 500 Euro banknotes

A large proportion of the notes in circulation are high denomination notes. In value, the EUR 500, EUR 200 and EUR 100 banknotes account for 54% of banknotes in circulation. The EUR 500 note alone accounts for around 30% of the value of banknotes in circulation, despite not being a common means of payment. Results of an ECB study show that around 56% of respondents have never come across a EUR 500 banknote. Indeed, many businesses are not inclined to accept high denomination notes purely due to practical issues such as associated security and fraud risks. On the other hand, countries like the US and Canada are good examples of the fact that an economy does not need high denomination banknotes in order to operate successfully.

While not all use of cash is criminal, almost all criminals use cash at some stage during the money laundering process. Indicators from international anti-money laundering investigations demonstrate that the EUR 500 is a favoured tool used by criminals to store the proceeds of illegal activities in non-financial environments. A case investigated by a EU MS, led to biggest ever cash seizure in this MS after finding EUR 8 million, almost entirely in EUR 500 notes inside one of the suspect's apartments. Another successful operation in which Europol participated led to significant seizures of cash belonging to a drug trafficking syndicate. Over 1.6 million of the illicit cash were found in a safety deposit box – all in 500, 200 and 100 banknotes.

Further, the large denomination banknotes are favoured by cash couriers. In order to facilitate the concealment of large sums of money, couriers often transport high denomination notes, in particular the 500 EUR. For instance, EUR 1 million in 500 notes equates to just 2000 notes weighing 2.2kg, taking up a space of just under 3 litres (which, for instance, would easily fit inside a small laptop bag). Meanwhile, the same amount of money (EUR 1 million) in EUR 50 notes equates to 20,000 pieces weighing over 22kg and taking up the space of a small suitcase. When considering the means of transport (often flights) and the means of concealment used by couriers (body packing, swallowing), the importance of shrinking the volume, but not the value of cash consignments is put in relief.

It is noteworthy that as early as 2005 the Financial Action Task Force (FATF) recommended that “countries should give consideration to the elimination of large denomination banknotes...used by cash smugglers to substantially reduce the physical size of cash shipments...and by doing so, significantly complicate detection exercises”

Based on today’s intelligence an accelerated withdrawal of the 500 Euro Banknote from the market would help to disrupt criminal cash business.

6. 200 Euro banknotes

The expert group also proposes to launch a discussion also involving the European Central Bank about a potential withdrawal of the 200 Euro banknotes from circulation. The reasons are the same as for the 500 Euro banknotes. The following example is given:

Project Restful (UK): In April 2010, the wholesale banknote market within the United Kingdom agreed to no longer issue €500 banknotes within the UK financial sector. This followed discussions with UK law enforcement who demonstrated the links between criminal activity and €500 banknotes. Following the removal of €500 banknotes from the UK wholesale banknote market, UK Law Enforcement saw criminals moving to €200 banknotes.

7. Money Laundering through HOSSPs to become a serious criminal offence

The requirement to have a predicate offence is often a reason why financial investigations are delayed or are not pursued at all.

The current proposal from the European Commission on a Directive on countering money laundering by criminal law⁹ is a move in this direction. It would establish minimum rules concerning the definition of criminal offences and sanctions in the area of money laundering. In the proposal migrant smuggling is proposed as a criminal activity for the purposes of the directive.

⁹ Proposal for a Directive of the European Parliament and of the Council on countering money laundering by criminal law (2016/0414(COD))

According to Article 3(a) "the conversion or transfer of property, knowing that such property is derived from criminal activity" is a punishable criminal offence, when committed intentionally. Furthermore, Article 3(2)(a) specifies that for the above offence, "it shall not be necessary to establish a prior or simultaneous conviction for a criminal activity that generated the property".

Therefore, this proposal is welcome, however it could be further expanded to make it sufficient to have "reasons to suspect" that a money laundering activity is pursued instead of the current formulation of "knowing".

The criteria should be expanded to anyone and not only the money launderer.

8. Consider Public Private Partnerships

1. Safer corridors¹⁰

In situations of crisis, restricted regulations or sanctions, and post-conflict recovery where the established banking system is compromised, remittances are mostly delivered to the intended recipients via an informal network. The goal of a safer corridor is to provide a secure route for funds that have been obtained legitimately and are for legitimate use and preclude the flow of illegitimate funds. With the support of governments, regulators, supervisors and international partners "safer corridors" with a three stage process ("first mile, clearance, last mile") can be established.

2. JMLITS (Joint Money Laundering Intelligence Task Forces)

JMLITs have the purpose to provide a collaborative response of the financial sector and government institutions and ensure the cleanliness of the financial market.

The vision is to provide an environment for the financial sector and governments to exchange and analyse intelligence to detect, prevent and disrupt money laundering and wider economic crime threats against the EU. As a benefit, banks can target money launderers more effectively.

¹⁰ „Safer corridors, rapid assessment, case study: Somalia and UK Banking”, September 2013, Beechwood International

The United Kingdom has established such entities. The establishment of JMLITs is recommended to other Member States as best practice. In addition, this initiative should be replicated at EU level to tackle the problem of limitation of national frameworks. As the flows of illicit money are mainly cross-border, such international perspective needs to be added to the financial system.

COSI is invited to take note of this note and to endorse its recommendations.
