Informal Value Transfer Systems:
A Financial Institution’s Perspective
EXECUTIVE OVERVIEW

Financial institutions today face a wide array of risks in the world of Anti-Money Laundering (AML). Key to addressing and preventing future risk is properly evaluating an institution’s Bank Secrecy Act program, whether as an external auditor, or a BSA Officer looking to conduct a self-assessment. While a high level overview can be valuable, certain issues merit a deeper look. This white paper explores how financial institutions are impacted by Informal Value Transfer Systems and how to properly examine and address the risks surrounding them.

An “informal value transfer system” refers to any system, mechanism, or network of people that receives money for the purpose of making the funds or an equivalent value payable to a third party in another geographic location, whether or not in the same form. The transfers generally take place outside of the conventional banking system through non-bank financial institutions or other business entities whose primary business activity may not be the transmission of money.¹

This paper aims to provide those tasked with auditing or assessing financial institutions a new perspective of Informal Value Transfer Systems (IVTS, also known as hawala). Currently not only is information on IVTS scarce, but the major research is conducted from the viewpoint of law enforcement and government regulators.

A key point of contention of this paper is that IVTS use the conventional banking system much more often than indicated by FinCEN; this is supported both by academic research and by the author’s practical experience. Thus, financial institutions’ current programs and practices may devote insufficient resources and focus to this area, which results in potentially insufficient mitigation.

As with any risk, each institution’s profile and exposure will be different. Within this paper you will find:

- What an IVTS is, how IVTS operates, and why IVTS exists;
- The specific risks posed by IVTS;
- Why your institution should specifically monitor for IVTS activity;

¹ FinCEN Advisory 33, Mar 2003
Methods for recognizing IVTS within your institution.

BACKGROUND

IVTS Basics

IVTS can go by many different names. Hawala. Hundi. Chop. Chit. Fei chien. Black Market Peso Exchange (BMPE). Some, such as hundi, pre-date traditional banking systems and are deeply ingrained within specific cultures. Others, such as BMPE, are more recent and were developed specifically to circumvent AML regulations. IVTS works by transferring value without the need to physically transfer money; most often no negotiable instruments are used, and the value is transferred solely by communication between IVTS operators.

IVTS relies on personal connections between operators in different locations, usually international, and is typically used for remittances. A standard transaction typically occurs when an individual will go to an IVTS operator to transfer funds abroad. The IVTS operator, after agreeing to a rate of exchange with the customer, will accept their funds, usually in cash. The IVTS operator then contacts their counterpart located in the country the funds are destined for. The details are exchanged, and the IVTS operator gives the customer instructions on how the beneficiary can receive their funds. No funds are actually exchanged or sent out of the country during the transaction; the two IVTS operators will settle their accounts at a later time, using a variety of methods which we will explore later in more detail.

With the prevalence of modern financial institutions, particularly in the West, why then use IVTS? There are five main reasons, shown here:

IVTS operators typically conduct other types of business in conjunction with their transfer services. Therefore their overhead is small, particularly when compared to a modern financial institution. Coupled with exchange rate speculation, they can offer much better rates to customers. The transfers take place quickly, without bank holidays and weekends delaying the funds.

IVTS is trust based; operators without trust do not stay in business for very long. Without the need to follow regulations or cumbersome approval or documentation processes, the simplicity is also appealing.

IVTS transactions are not inherently illegitimate. As can be seen from the table above, out of the five major benefits of IVTS, only the lack of a paper trail is what creates an inherent risk of money laundering. This anonymity, via the lack of paper trail and customer identification, makes them an attractive option for those seeking to move illegitimate funds around the world. Just like their formal financial institution counterparts, IVTS operators seeking to serve a legitimate need may find themselves used to facilitate money laundering.

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2 FinCEN/INTERPOL, Jan 2000
Although the transactions may not be illegitimate, IVTS operators fall under the definition of a money transmitting business:

Any person who engages as a business in an informal money transfer system or any network of people who engage as a business in facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system.  

As a money transmitting business, IVTS are required to register as a money services business (MSB) with FinCEN. By not registering, IVTS operators are subject to civil penalties and/or imprisonment. As an unregistered MSB, the discovery of an IVTS operator at your institution will most likely necessitate the filing of a Suspicious Activity Report (SAR). Policies and procedures should be in place requiring the verification of MSB registration, with exception procedures, such as SAR filing, when registration is missing or invalid.

IVTS Settlements

With real currency exchanging hands in separate countries within days, how do IVTS operators recoup their funds? Understanding the settlements process is vital, as this is primarily where IVTS touches modern transaction systems and can be detected. Below is a list, by no means exhaustive, of settlement methods.

- **Under/Over-Invoicing of Goods**
  - As mentioned earlier, IVTS operators often run other businesses in conjunction with the IVTS. Goods can be shipped and over or under valued, in order to settle the balance owed between operators. Financial institutions may be able to see this activity if they are involved in issuing letters of credit by reviewing the bill of lading for the goods in question.

- **Negotiable Instruments**
  - While not used directly for the initial transfer process, settlements can at times take place via money orders, official checks, or stored value cards. Unusual purchase patterns of these instruments, particularly in cash, may be seen by the financial institution. Unusual deposit patterns may exhibit themselves in the account as well, although this is more likely related to the acceptance stage than the settlement stage.

- **Bank-to-Bank and Intra-Bank Transfers**
  - More recently, many institutions offer their account holders the option to transfer funds directly to an accountholder at another institution or within the same

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3 USA PATRIOT Act Section 359(b)
institution. This has the benefit of being fully automated and does not require bank personnel to be involved. However, many transaction monitoring systems may not take these transfers into account, particularly intra-bank transfers. This can be a significant touch point between IVTS and financial institutions.

- Wire Transfers
  - A straightforward process, which may be disguised as part of normal business operations.

- Transaction Offset
  - Remittances can flow both ways; over the course of time, transactions can be coordinated between different operators so that the amounts sent and received offset, requiring no additional actions to settle. This will not be seen by a financial institution.

- Courier Services
  - Physical currency or even precious metals and gems may be physically transported to settle accounts. This will not be seen by a financial institution; however, the purchase of either commodities or the courier services themselves may be seen within the transaction history of the account.

Risk Management

As with other AML risks, the risks from IVTS are multi-dimensional. From regulatory to reputational, when evaluating a program it is important to insure the stakeholders know who is doing what at the institution.

IVTS specifically makes this difficult, if not impossible, for a financial institution. Even from a law enforcement perspective, IVTS record-keeping is either non-existent, minimal, or kept in such a manner as to be identifiable only by the operators themselves. Thus, the institution is essentially carrying a foreign pass-through account with an operator that has no AML or sanctions program. Furthermore, these transfers are often to and from high-risk jurisdictions such as Pakistan and Nigeria. Thus evaluating the control framework, specifically in relation to IVTS, is vital.

As stated earlier, although FinCEN acknowledges that, “[...] IVTS transactions occasionally interconnect with formal banking systems⁴”, said acknowledgment only comes after the initial statement that this is generally not the case. However, according to leading research commissioned by the Department of the Treasury, this is not true.

⁴ FinCEN Advisory 33, Mar 2003
Both of the previous statements and reports corroborate the author’s own personal experience; while traditionally IVTS may have been conducted without financial institutions, modern IVTS is very practical and utilizes whichever system works best for their particular need. Next, we will uncover much more specifically how these interactions take place.

Detection: The Four Dimensions

In order to mitigate the aforementioned risks, it is recommended that institutions have specific logic within their transaction monitoring systems, or separate reporting, to better identify IVTS activity. Although this may be done as a subset of MSB detection, there are key differences. An IVTS most likely will not be cashing checks or issuing negotiable instruments such as money orders. The sole purpose of the IVTS is to transfer value, not to provide general banking services.

There are four primary dimensions to IVTS detection. They are:

1. Account Profile
2. Geography
3. Transactions
4. Connections

These dimensions are not distinct silos. Rather they are variables that constantly interplay with one another. Each adds or detracts risk from the other at any given interaction. The following detection methodologies are not meant to be a comprehensive list for AML anomaly detection. Rather, these methods should be layered with other more standard anomalous transaction monitoring to specifically identify IVTS activity.

Account Profile

Although IVTS usually operate alongside another business, IVTS activity often can occur in personal accounts. That being said, it is much harder to detect when being operated in conjunction with another business.

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5 IVTS, Terrorism and Money Laundering, Nikos Passos, Jan 2009
6 A Report to Congress in Accordance with Section 359 of the USA PATRIOT ACT, U.S. Dept. of the Treasury, Nov 2002
Per Interpol, the following business types are more likely than others to be involved in IVTS:

**Common Businesses Operated in Conjunction with IVTS**

- Import/Export
- Jewelry (gold, precious stones)
- Rugs/Carpets
- Car Rentals (usually non-chain or franchise)
- Travel and Related Services
- Foreign Exchange
- Used Cars
- Telephones/Pagers

**Geography**

While reviewing the risk assessment of an institution, consider whether a separate rating for IVTS activity would be appropriate. With certain countries much more likely to utilize IVTS, analyzing customer passports, addresses and transaction originations and destinations helps to differentiate IVTS activity from other scenarios.

**Common Geographies Associated with IVTS**

- Afghanistan
- Colombia
- Hong Kong
- Iran
- Kenya
- Malaysia
- Pakistan
- Senegal
- Sri Lanka
- China
- Dubai
- India
- Iraq
- Kurdistan
- Nigeria
- Philippines
- Somalia
- Vietnam

This list is simultaneously not exhaustive and too broad. Depending on the country the institution is located in or the particular customer base, IVTS activity may vary. For example, a report published by the Australian Institute of Criminology focused on IVTS activity involving India, Vietnam, and Samoa. In the United States, Samoan IVTS activity would not be likely to

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7 FinCEN/INTERPOL, Jan 2000
8 Money laundering and terrorism financing risks posed by alternative remittance in Australia, Australian Institute of Criminology, 2010
rise to that significance. As with any risk, this will need to be tailored to the specific institution.

Along with identifying countries with propensities for IVTS, further qualifying these countries with capital controls can generate higher quality reporting. For example, in order to avoid reporting moving US dollars out of Nigeria, an IVTS operator may structure multiple wires just under the $10,000 reporting limit. They will originate wires from separate accounts in Nigeria to multiple individuals in the US, then via inter- or intra-bank transfer aggregate the funds back into the desired account.

Transactions

Finally, there are the transactions themselves. Below is a list of transaction types and examples of their usage:

- **Wire Transfers**
  - Usually international.
  - Method for settling ending balance of numerous transfers.
  - Method for single larger transfers.

- **Inter-Bank Transfers**
  - Given the trust inherent in IVTS, systems usually intended for the same individual to transfer funds between their accounts at different institutions can instead be used to transfer funds to another individual.
  - Can be used for both transfers and settlements.

- **Intra-Bank Transfers**
  - As IVTS grow to use more of the modern banking system, and the modern banking system grows to cover traditionally underserved areas, funds can be moved among individuals at the same institution. Entire ethnic or community IVTS can be established within the confines of a single institution.
  - Can be used for both transfers and settlements.

- **Negotiable Instruments**
  - Higher dollar instruments can be indicative of settlements (purchase or deposit); deposits of large numbers of smaller instruments is likely indicative of the funding of individual transfers. May be made payable to parties other than the accountholder.

- **Debit/ATM Cards**
  - Cards can be distributed to trusted operators in a different location.
  - Funds are deposited in one location and withdrawn via ATM in another distant location.
  - Rapid ATM withdrawals at the same ATM location, by different cardholders.
  - Used for transfers.
INFORMAL VALUE TRANSFER SYSTEMS: A FINANCIAL INSTITUTION’S PERSPECTIVE

- **Cash**
  - Usually deposited or withdrawn as part of the settlement process; large single cash transactions made at the financial institution are usually aggregations of multiple smaller transactions.
  - May be structured; however, if the IVTS is also operating a cash-intensive business, it may be commingled with business proceeds.

**Connections**

One of the indicators of an IVTS is that an operator will have dealings with many different individuals whose relationship to the operator will be difficult to determine. With IVTS utilizing inter- and intra-bank transfers, transaction monitoring can be used to identify accounts with unusual numbers of connections to other individuals:

- **One-to-many**: The account originates many transfers to many different individuals.
- **Many-to-one**: The account receives transfers from many different individuals.
- **Raise risk related to the geographies involved, particularly transfers to/from other countries with a high prevalence of IVTS.**
- **Many of these transactions allow the customer to input a short comment of their own. Comments noting foreign currency or common currency exchange notations (e.g., “1000 at 25”) are further indicative of an IVTS.**

As with any AML scenario, the specific variables and thresholds will be institution-specific. However, these four dimensions should be a guide in order to appropriately rate the strength of the institution’s controls around IVTS.

**Audit and Validation**

As one of the four pillars of a strong AML program, policies or procedures should specify the audit process encompasses validating IVTS monitoring. This needs to be done from both a detailed and a “big picture” viewpoint. From a high level, management needs to be aware of and measure the risks of IVTS as part of the standard AML risk assessment process. At the detailed level, data validation must be done to insure that transaction monitoring systems are properly configured. This includes:

- **Systems recognize and monitor all transaction types, including intra-bank transfers.**
- **Systems recognize and monitor not just the “top level” transaction type, but also vital transaction details.**
  - For example, a legacy system may only recognize a transaction as “wire transfer” and not the underlying details of the transaction, such as the currency it is in or the country of origin/destination.
While transaction monitoring is one of the key controls, automated systems are not effective without people behind them with the appropriate knowledge and training. IVTS recognition is part of an appropriate training program for BSA personnel.

**Conclusion**

Informal Value Transfer Systems, just as their more formal financial institution counterparts, are predominantly used for legitimate purposes. However, unlike financial institutions, IVTS lack the proper policies and controls to combat money laundering and terrorist financing.

Because of this, it is imperative that financial institutions learn to specifically monitor for these accounts. As an AML professional, you would not permit a foreign pass-through account without specific, stringent controls. Yet an IVTS is just that, a pass-through account with no controls for sanctions, AML or terrorist financing. With the controls advised in this paper in place, AML professionals can better protect their institution from being the next regulatory finding or headline story.
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