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Financial Crimes Enforcement Network

FinCEN Advisory

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Informal Value Transfer Systems

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This advisory provides financial institutions with information concerning Informal Value Transfer Systems (IVTS).

The purpose of this advisory is to educate the financial community about IVTS by:

1) explaining the operation of IVTS;
2) describing how financial institutions may be used in the IVTS process; and
3) identifying how the Bank Secrecy Act, as amended by the USA PATRIOT Act, regulates IVTS operators.

What is IVTS?

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. The IVTS transactions occasionally interconnect with formal banking systems (for example, through the use of bank accounts held by the IVTS operator.)[1]

IVTS, including so-called alternative remittance and underground banking systems, pre-date western banking systems and existed as far back as 5800 BC. The systems were established originally on the Indian subcontinent in Asia as a means of settling accounts within villages. Their use as global networks for financial transactions spread as expatriates from the original countries settled abroad. Today, IVTS operations are found in most countries. Depending on the ethnic group, IVTS are called by a variety of names including, for example, "hawala" (Middle East, Afghanistan, Pakistan); "hundi" (India); "fei ch'ien" (China); "phoe kuan" (Thailand); and "Black Market Peso Exchange" (South America)[2].

Individuals or groups engaged in operating IVTS may do so on a full time, part-time, or ad hoc basis. They may work independently, or as part of a multi-person

[1] From the Report on Money Laundering Typologies 2002-2003, Financial Action Task Force (FATF) on Money Laundering
[2] Reference FinCEN Advisories Number 9 and Number 12 on Black Market Peso Exchange, http://www.fincen.gov

network. IVTS are based on trust. Historically, operators have not, as a general rule, misappropriated the funds entrusted to them.

Section 359 of the USA PATRIOT Act expanded the definition of "financial institution" to include not only a licensed sender of money but any other person who engages as a business in the transmission of funds, including 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 the conventional financial institution system.[3] Any individual or group of people engaged in conducting, controlling, directing or owning an informal value transfer system in the United States is operating as a financial institution. Therefore, IVTS operators must comply with all Bank Secrecy Act (BSA) requirements, which include establishment of an anti-money laundering (AML) program[4], registration with the Financial Crimes Enforcement Network (FinCEN) as a money services business[5], and compliance with the record keeping and reporting requirements, which include filing suspicious activity reports (SARs)[6].

Use of IVTS

IVTS are utilized by a variety of individuals, businesses, and even governments to remit funds domestically and abroad. Expatriates and immigrants often use IVTS to send money back to their families and friends in their home countries. IVTS operations are also used by legitimate companies, traders, and government agencies needing to conduct business in countries with no or inadequate formal financial systems.

In some countries, IVTS-type networks operate in parallel with formal financial institutions or as a substitute or alternative for them. United States citizens, persons (legally or illegally) residing in this country from foreign countries, and individuals living in other nations may prefer or need to use IVTS in lieu of formal financial institutions for various reasons as described below:

- the political instability, inadequate payment systems, and/or an unstable financial sector that exist within a country;
- a lack of easily accessible formal financial institutions in remote areas of some countries;

[3] See 31 U.S.C.5312(a)(2)(R)
[4] See 31 CFR 103.125
[5] See 31 USC 5330 and 31 CFR 103.41. The registration requirement applies only to principals of such businesses, and not to their agents.
[6] See 31 CFR 103.20

- transfers that are more efficient, reliable, and cheaper than formal financial institutions. (For example, a wire transfer of funds using banks involves fees charged to the sender and receiver, may take from two to seven days to complete, and may be delayed or lost. Funds moved through IVTS are available within 24 hours, with minimal or no fees charged to the participants.);

- to avoid paying higher foreign exchange rates. (Funds sent through traditional transfers are converted to the currency of the recipient's country; the fee charged for exchange rate conversion is set by the institution. IVTS operators, who speculate in currency exchange rates, charge lower fees.);

- to avoid currency reporting controls. (The United States, along with many foreign governments, has established currency reporting requirements for financial institutions. Some expatriates and citizens distrust governments and wish to circumvent any reporting of their financial activities.);

- to avoid paying taxes; or

- to ensure anonymity since there may be minimal or no records maintained; in other words, no paper trail exists.

Because IVTS provides security, anonymity, and versatility to the user, the systems can be very attractive for misuse by criminals. Recent law enforcement investigations have shown direct links between criminal elements and the use of IVTS mechanisms for the purpose of moving and laundering illicit proceeds[7]. In addition, law enforcement officials in India and other countries have identified terrorist organizations that frequently utilize IVTS to move terrorist funds. The vulnerability of IVTS in moving money on behalf of criminal organizations, as well as their potential misuse by terrorist organizations, pose a substantial investigative challenge to the U.S. law enforcement community. If the IVTS operator, like any other financial institution, fails to comply with the BSA requirements, it becomes a "weak link" and therefore invites illicit proceeds and terrorist money into the U.S. financial system. Despite such vulnerabilities, it should be stressed that IVTS operations, which are in compliance with the BSA regulations, can and do provide legitimate services to many customers who customarily prefer to use these types of financial services providers.

[7] See Treasury/FinCEN Report to Congress in Accordance with Section 359 of the USA PATRIOT Act, http://www.fincen.gov

IVTS Operations

Two types of IVTS exist – a traditional system with similar characteristics and operations like those used centuries ago; and a modern or contemporary system that frequently intersects with customers and accounts in formal financial institutions. The process may be very simple or quite complex, depending on the IVTS type.

Traditional IVTS

In a **basic** or **traditional IVTS** transaction (such as hawala), four participants are required: a sender of the funds, a recipient of the funds, and IVTS operators in the respective countries of the sender and recipient. The following exercise demonstrates an example of a basic IVTS transfer where an individual (#1) in Country A wants to send money to an individual (#2) in Country B.

Step One: Individual #1 gives currency to an IVTS operator in Country A.

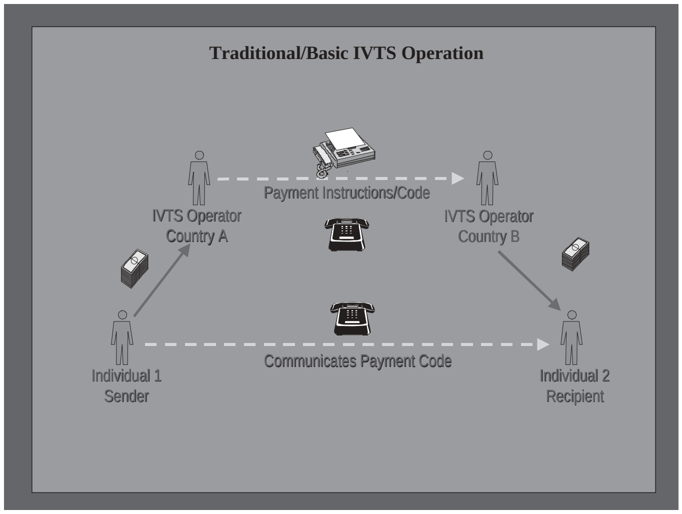
Step Two: The IVTS operator in Country A provides Individual #1 with a code or other identification mechanism.

Step Three: The IVTS operator in Country A notifies his counterpart in Country B by phone, fax, or e-mail of the transaction amount to pay Individual #2 and the code.

Step Four: Individual #1 contacts the intended recipient, Individual #2, in Country B and provides the code to that person.

Step Five: Individual #2 goes to the IVTS operator in Country B, gives the appropriate code, and picks up the specified funds sent to him.

The following diagram illustrates this basic IVTS operation:



The IVTS operator charges a flat fee, a commission, or may alternatively, or in addition, profit from the exchange rate differential between the official and the black market price of U.S. dollars in Country B.

No money is actually transferred. The IVTS operator in Country A uses the money received from senders to "stock" his cash supply for use in future payments for incoming requests to him. The situation is reversed in Country B where the IVTS operator's cash is generated from senders in his country. Account settling may be accomplished through other methods such as: the physical transfer of currency across borders between operators by couriers; the use of the accumulated currency to purchase easily moveable commodities, which are then exported, subsequently sold, and the cash generated from the sale is provided to the second IVTS operator; as payment for goods to be traded; by smuggling or trading gold and precious gems, i.e., diamonds or tanzanite; or through invoice manipulation (overcharging or undercharging for goods or services).

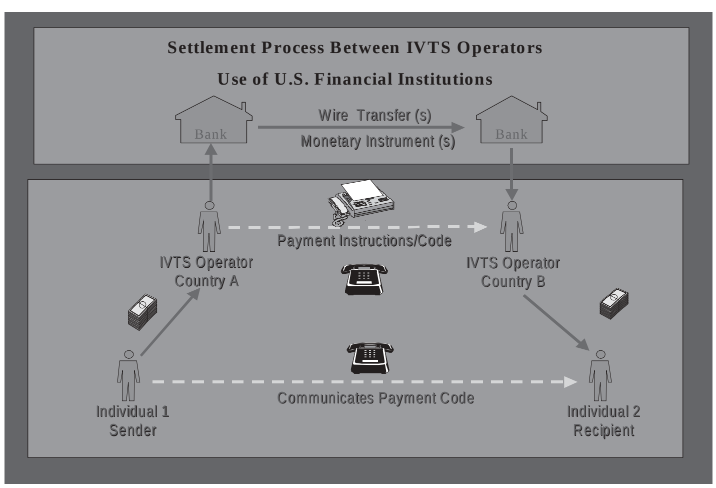
Modernized IVTS

A **modernized or contemporary IVTS operation** often involves the use of traditional financial institutions like banks to complete the process. A business owner may offer IVTS services as part of a cash intensive business like a convenience store, grocery store, restaurant, import/export company, travel agency, etc. In addition to conducting his routine business, the owner accepts money from his "clients" for transfer to individuals in other countries. The business owner may not be licensed by the state to operate as a money transmitter and/or may not be registered as a money services business (MSB) with FinCEN.

The initial process is similar to a traditional IVTS transfer in that steps one through five are followed. The profits to the operator are similar. However, the account settlement process differs. The money received from the IVTS operation is co-mingled with the funds generated from the regular business and deposited into a commercial or personal account at the local bank. After a period of time, during which funds from multiple IVTS transactions accumulate, the business owner sends a wire transfer from his account directly to the IVTS operator in Country B for the monies owed for the multiple IVTS transactions. An alternative may be that the funds are wired first to accounts established in financial institutions in IVTS hub regions [e.g., United Arab Emirates (U.A.E.), London, New York, or Hong Kong]. The funds are ultimately provided to the IVTS operator in Country B by either a subsequent wire transfer to an account at the operator's bank or the money may be withdrawn and physically delivered to the operator.

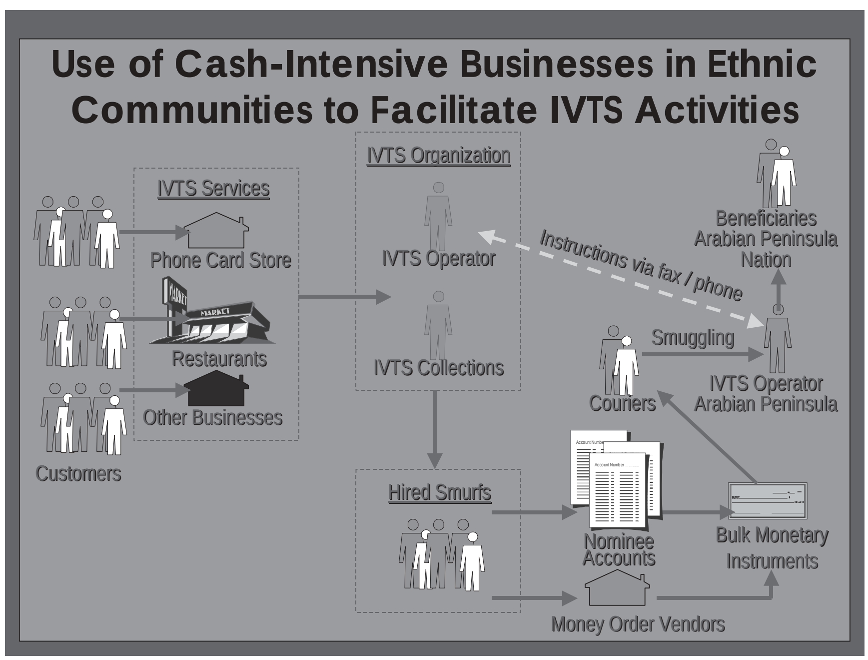
Another method of account settlement involves funds deposited and accumulated in the IVTS operator's bank account in the United States. After a period of time, negotiable instruments (e.g., cashier's checks or money orders) are purchased with funds withdrawn from the domestic account. The negotiable instruments are subsequently smuggled abroad to foreign counterpart IVTS operators to settle their accounts. Funds from the negotiable instruments may also serve as direct payments to the beneficiary.

Law enforcement investigations have shown the majority of IVTS cases detected in the United States involve the use of formal financial institutions to move funds as part of the settlement process between IVTS operators, as illustrated below.



A Case Study – Use of Cash Intensive Businesses in Ethnic Communities to Facilitate IVTS Activity

U.S. law enforcement efforts identified an organization that provided unlicensed remittance services for nationals of another country residing in the United States. Numerous businesses within the ethnic community, including restaurants, travel agencies, and other miscellaneous stores, collected money from individuals wishing to send funds back home. A small fee was charged for the transfer services and each sender was provided with a code to provide to the beneficiary. The U.S. IVTS operator then telephoned and faxed all of the transaction orders to the IVTS operator located in the foreign country. The beneficiaries of the transfers were paid before the actual settlement of funds occurred. Meanwhile, an agent for the organization collected the cash from the various stores. Several individuals were enlisted to convert the bulk cash to money orders and other negotiable instruments. Cash deposits were also structured into nominee accounts maintained at local banks. Checks were then issued from those accounts. [Financial institutions that recognized the structured and suspicious activity subsequently filed Suspicious Activity Reports (SARs) to FinCEN.] The money orders and checks were provided to couriers who physically smuggled the instruments to the IVTS operator in the foreign country where the instruments were negotiated through correspondent accounts maintained by a U.S. bank.



For additional case related patterns involving IVTS and the relationship to financial institutions accounts, refer to The U.S. Treasury Department/FinCEN Report to Congress in Accordance with Section 359 of the USA PATRIOT Act, http://www.fincen.gov.

IVTS-Related Transactions and Other Activity Conducted Within Financial Institutions

As stated previously, IVTS operators offer a valuable service for certain segments of the population and many operators comply with the BSA requirements. The above case study relates how a financial institution may be used in an IVTS process. Some of the types of transactions and other activities indicative of modern or contemporary IVTS operations are provided below. Taken individually, the transactions or other activities do not necessarily equate to IVTS. However, combinations of transactions or activities should raise the level of concern about potential IVTS connections. Also, note that the following types of transactions apply not only to IVTS, but other suspicious banking activity as well. These transactions and other activities were observed in the IVTS operations examined for the Treasury/FinCEN Report to Congress.

<u>Transactions</u>

- Transactions are conducted contrary to the expected profile of a business entity or customer including:
    - sudden and/or unexplained deposits of cash for a business that previously had few or minimal cash deposits;
    - frequent financial transactions in comparison with those of other same scale businesses located and operating in the same area;
    - large and/or mixed deposits of cash and monetary instruments;
    - periodic aggregate wire transfers sent to IVTS hub regions (e.g., UAE; London; New York; Hong Kong).
- Frequent, large cash shipments are completed that exceed the norm for a small business operation.

- Structured cash deposits are made and subsequently followed by international wire transfers. The wire transfers may be immediate and completed daily or funds may accumulate in one or more accounts over a period of time, then wired abroad.

- Frequent deposits or negotiation of third party checks, many drawn on out-of-state banks, are conducted. The volume of check deposits is inconsistent with the expected volume or the anticipated type of transactions for the bank customer.

- Structured cash purchases of monetary instruments, including money orders or bank checks, made payable to the same individual or entity, are frequently completed.

- Daily or every few days, structured cash deposits are made to personal or business accounts, immediately followed by automated (ACH) debits to international money transmitters.

- Currency that appears structured is deposited into personal or business account(s), followed by withdrawals of funds used to purchase negotiable instruments.

- Monetary instruments lacking payee/payor information are presented. Unusual codes, markings, and/or stamps not indigenous to typical banking practices appear on the face or back of the instruments.

- Negotiable instruments that were clearly purchased in bulk and/or consecutive order (e.g., sequentially numbered and purchased at same branch location) and are made payable to a common beneficiary are negotiated.

- Purchases of negotiable instruments appear structured to circumvent federal recording and reporting requirements.

- Transactions are discovered that involve unusual business trade connections for the bank customer (e.g., small scale auto parts dealer sending aggregate wire transfers to a precious metal dealer or agricultural importer).

- Account activity involves only cash or monetary instrument deposits followed by one-way wire transfers, especially to IVTS hub locations.

Other Activities

- Bank customer makes incriminating statements indicating transactions are conducted on behalf of third parties who wish to send money to OFAC blocked countries.

- The institution discovers a customer maintains separate client records for no apparent business or legal purpose.

- The institution discovers a customer is generating unusual commission-based revenues possibly linked to IVTS activities (Note: Criminals may be charged higher fees by IVTS operators.)

Regulating IVTS in the United States

As indicated earlier, the USA PATRIOT Act expanded the definition of "financial institution" to include IVTS operators. As such, they now must comply with all BSA registration, recordkeeping, reporting and AML program requirements.

"Money transmitting" occurs when funds are transferred on behalf of the public by any and all means including, but not limited to, transfers within the United States or to locations abroad by wire, check, draft, facsimile, or courier. Section 5330 of the BSA and FinCEN's implementing regulations require all money transmitting businesses (but not their agents) to register with FinCEN. The obligation to register rests with the persons who own or control the money transmitting business. Section 1960 of Title 18 makes it a felony to operate an unlicensed money transmitting business.[8] A money transmitter that conducts business without an appropriate money-transmitting license in a state where such operation without a license is punishable as a misdemeanor or a felony is an unlicensed money transmitter even if the transmitter did not know the operation required licensing or that the operation was a crime. Additionally, a money transmitting business that fails to register with FinCEN as an MSB, is operating as an unlicensed money transmitter. Penalties for operating an illegal money transmitting businesses include civil and criminal fines, imprisonment for not more than five years, or both.

What to do:

A financial institution that knows or suspects that a customer is operating as an illegal money transmitter should file a SAR to FinCEN. A depository institution should check the "Other" box in Part III, Line 35(s) on Form TD F 90-22.47 and

[8] See 18 U.S.C.1960

note the abbreviation “IVTS” in the space following the box. Also, the narrative should include an explanation why the depository institution suspects or has reason to suspect that the customer is operating as an illegal money transmitter. Other types of financial institutions required to file SARs should check the “Other” box in the “Type of Suspicious Activity” section on their appropriate SAR form, note the abbreviation “IVTS” in the space following the “Other” box, and provide an explanation why the financial institution suspects or has reason to suspect the customer is operating as an illegal money transmitter.

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Director

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