

In Defence of Hawala: Rethinking Regulation of Customary Banking

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This article concerns the regulation of hawala in the United States under the existing financial services regulatory environment and how the hawala system is not particularly suited to conforming to these expectations. Originating in the Middle East, hawala is an ancient and highly decentralised system of transferring money using two independent brokers called hawaladars. In more recent history, it has gotten much bad publicity for the role hawala transactions play in financing terrorist operations, facilitating tax evasion and frauds through trade based money laundering. It is very informal and decentralized, making the hawala industry exceedingly difficult to regulate. Accordingly, few hawaladars voluntarily comply with existing anti-money laundering, know your customer and counter terror finance rules - let alone even follow standard principles of accounting. In an era of a hyper-globalised financial system, a failure to accommodate alternative models of finance and banking can have high costs on domestic institutions losing access to profitable frontier markets and even higher social costs on developing economies losing lifelines to remittances they depend on. In spite of this, there are a number of measures and policies that financial services regulators can implement that will assist in bringing the hawala industry into greater compliance with the existing financial regulatory programmes that apply to all money services businesses and financial institutions.

I. INTRODUCTION

Hawala is definitely not a household word for those of us in the West. Few here have ever heard of it. Nor does it enjoy the sort of dominance it formerly enjoyed in the wider Middle East and North Africa region where it was once the sole means of moving money across great distances. It has been reduced in status to that of a sizable niche service. In many respects, hawala is the most basic banking service available, and like most extremely basic services, it has fallen victim to innovations like drafts and electronic transfers. But some corners of the world haven't been as lucky in joining the global economy as others. Even with its steep decline in market share, hawala thrives in the Persian Gulf and in diaspora communities where it serves an important economic role in channelling remittances back home.

This is the background to our current conversation. The real issue at stake with hawala isn't so much that an anachronistic financial service still competes with more modern alternatives, but that it skirts consumer protections, state licensing and basic practices of good banking that are applied at great cost to the rest of this heavily-regulated industry. It is precisely for these reasons that terrorist cells in particular have used the hawala network to fund cells abroad that carry out attacks.¹ Being largely unregulated and outside the mainstream financial industry, it is very easy to see how this is a weak spot in countering the finance of terrorism. Tax evasion and frauds are also frequently tied to the hawala network for want of ordinary due diligence and a black market culture that is all too willing to turn a blind eye to financial crimes.

The article seeks to address ways that the regulatory state can more easily accommodate independent hawaladars and hawala businesses so that they move their operations out of the underground economy and into the mainstream where there is a smaller risk of facilitating the finance of terrorism and running afoul of the law. There are several key ways regulators at the state and federal level in the United States can improve the regulatory regime to work better for the hawaladars, their clients and the frontier markets where the global financial system does not compete for business, leaving nothing but the hawala system.

II. THE HISTORY OF HAWALA

Hawala is an ancient money transfer system that came to play a prominent commercial role in the Middle East, but likely migrated there from South Asia or Europe where nearly identical or very similar systems of exchanging obligations through brokers formed the basis of the Medieval banking system.² It is a simple system of transferring money without movement through affiliated brokers known as 'hawaladars' using various means of communication. While newer banking methods developed in Europe and displaced customary channels in most of the world, the Middle East and North Africa have resisted this trend for various reasons. Although most people today consider the word synonymous with 'trust', as it is supposed to be the common element connecting transactions, the Arabic root for the word means 'to change' or 'transform'. This is somewhat ironic, since (as detailed below at greater length) there is little transformation or even

¹ Joseph Wheatley, 'Ancient Banking, Modern Crimes: How Hawala Secretly Transfers The Finances Of Criminals And Thwarts Existing Laws' [2005] 26 University of Pennsylvania Journal of International Economic Law.

² Maryam Razavy, 'Hawala: An underground haven for terrorists or social phenomenon?' (2005) 44 Crime, Law & Social Change 277, 292.

physical movement of anything - it simply connects countervailing debits and credits in different locales to efficiently meet demands.

Its precise origins are not well documented, but given its lack of complexity and contemporary existence of similar banking methods elsewhere in Asia and a developing system of promissory notes in Europe, it is not likely that hawala developed in a complete vacuum. This type of system has many counterparts throughout the world, most of which verifiably predate hawala and Islam.³ Given its lack of complexity, it is not hard to see why. A similarly ancient system called 'hundi' is prevalent in India.⁴ Even China has two local equivalents: 'fei ch'ien' in the north and 'hui kuan' in Canton and Hong Kong.⁵ Then the Philippines' local variety is called 'padala'. The Financial Crimes Enforcement Network (FinCEN), which is the national financial intelligence unit of the US Department of the Treasury, refers to all of these as Informal Value Transfer Systems (IVTS).⁶ To some extent, they are all the same system under different names and used by different ethno-religious-linguistic communities. or the most part, they are all in decline today, thanks to modern banking institutions even in the Middle East, and face similar problems of being conduits of illicit proceeds and off the books frauds. In tracing these individual occurrences of the same phenomenon, the historical record indicates a common origin in China approximately 2000 years ago and arrival to the Middle East via India sometime in the 12th Century.⁷

There are various hadiths, Sunnahs and other religious authorities in Islamic jurisprudence that lend weight to a variety of Islamic banking practices, but none specifically name and explain the dynamics behind hawala until much later on.⁸ There is no actual mention of it by name until 1327.⁹ The theological and doctrinal foundations presented are rather vague and general, leading one to the conclusion that official religious sanction that came after hawala became a common and well-developed network of financial guarantors.¹⁰

A more likely story, but arguably less popular for political and cultural reasons, is that hawala was developed by Crusader nobleman in the Levant who needed to transfer wealth from home to pay

³ Wheatley (n 1) 348-349.

⁴ L. C. Jain, 'Indigenous Banking In India.' [1929] *Economica*.

⁵ El Qorchi M, Mambo S and Wilson J, 'Informal Funds Transfer Systems: An Analysis Of The Informal Hawala System' [2003] Occasional Paper.

⁶ 'Informal Value Transfer Systems' [2003] FinCEN Advisory.

⁷ Razavy (n 2) 292ff.

⁸ N.D. Ray, 'The Medieval Islamic System Of Credit And Banking: Legal And Historical Considerations' (1997) 12 *Arab Law Quarterly. Shi'a Islamic Laws on Hawala According to the Fatawa of Ayatullah al Uzama Syed Ali al-Husaini Seestani*, <http://www.al-islam.org/laws/transactions3.html#_2298> accessed 11 October 2015.

⁹ Matthias Schramm and Markus Taube, 'Evolution and Institutional Foundation of the Hawala Financial System' [2003] 12 *International Review of Financial Analysis* 405, 405-407.

¹⁰ See S. Kapoor, *Bad Money, Bad Politics: The Untold Hawala Story* (first published 1998, New Delhi: South Asia Books, 1998).

their soldiers. In the time of Julius Caesar, Rome employed *praescriptiones* in commercial transactions, which differ little from cheques today that involve syndicates of redeeming agents much like hawala.¹¹ The Knights Templar also operated as a banking group that accepted deposits and issued letters of credit for redemption to Crusaders and pilgrims.¹² In any event, it came into particular favour with merchants tied to the bandit-laden Silk Road and treacherous Indian Ocean trade sometime after the 11th Century.¹³

Up until perhaps the mid-20th Century, hawala dominated the Middle East financial services scene. There were few alternatives available and fewer still of any use to the majority of the populace. Outside of the more westernised regions on the peripheries of the Mediterranean like Egypt, Lebanon and coastal North Africa, western-style banks provided no checking and correspondent banking services in the region. But then urbanization happened, and an oil boom in the Persian Gulf closely followed by a little thing called globalization.

Today, hawala is a big business in the United Arab Emirates and acts as something of a global hub for hawala transactions. Immigrant communities in Europe, North America and Australia - of which Somalis are most frequently associated due to the outsize role remittances play in that country - and Afghanistan, Pakistan and many other countries in the Middle East, North Africa and Western Asia are frequent destinations of hawala transfers. Today, the hawala model is being applied to some extent via an online money transmitter called TransferWise based out of London that performs transactions through a sophisticated automated online system that essentially does the same thing as a hawaladar.¹⁴ Once again, the pressures of disruptive innovations compete with existing forms of financial commerce. It is a story as old as time.

Today, the global hawala business potentially exceeds total receipts of US\$100 billion per year, with about 60% of it moving funds from developed countries to underdeveloped ones.¹⁵ Unregulated flow of remittances across borders has implications for macroeconomic policy as

¹¹ Will Durant, *Caesar and Christ: A History of Roman Civilization and of Christianity from their Beginnings to A.D. 325: The Story of Civilization #3*, (first published 1944, New York: Simon & Schuster 749).

¹² See Frank Sanollo, *The Knights Templars: God's Warriors, the Devil's Bankers*, (Taylor Trade Publishing, USA, 2003); Alan Butler and Stephen Dafoe, *The Warriors and the Bankers: A History of the Knights Templar from 1307 to the Present* (first published 1998, Belleville: Templar Books); Sean Martin, *The Knights Templar: The History & Myths of the Legendary Military Order*, (first published 2005, New York: Thunder's Mouth Press) 47; Helen Nicholson *The Knights Templar: A New History*, (first published 2001, Stroud: Sutton) 4.

¹³ Douglas Frantz, 'Ancient Secret System Moves Money Globally', *New York Times*, (New York, 3 October 2001) B5.

¹⁴ Rob Price, 'London's \$1 Billion Finance Startup TransferWise Is Just Like An Ancient Islamic Money Transfer System' (2015) *Business Insider*<<http://www.businessinsider.com/transferwises-similarities-to-hawala-2015-1?r=UK&IR=T>> accessed 21 December 2015.

¹⁵ Roger Ballard, 'Coalitions of Reciprocity and the Maintenance of Financial within Informal Value Transmission Systems: The operational dynamics of contemporary hawala networks' (2005) 6(4) *Journal of Banking Regulation* 319.

well, and affects many national statistics.¹⁶ Given the nature of the business though, it is very difficult to make exact estimates regarding informal economic activities through IVTS.

Although Somalia accounts for a large percentage of this traffic, Afghanistan's national economy is effectively dependent upon hawala.¹⁷ Given the rampant corruption affecting the Afghan banking industry and high-profile bank failures marred by corruption, even most international aid organisations operating in the country utilise hawala for their banking out of necessity.¹⁸

III. HAWALA IN THEORY AND PRACTICE

The theory behind hawala is fairly straightforward. As the most basic and among the first proper 'banking' services ever offered, its lack of complexity should surprise no one. But its origins and structure have substantial differences from the approach taken to most financial services in law and backend operations. For those with an interest in the law of equity, it is notable that Islamic law does not recognize equitable interests or constructive trusts like many other legal systems do. In an ordinary hawala transaction, the money in question always belongs to the receiver even if they are not in possession or are unaware of it.¹⁹ For the outside observer, it may seem peculiar that the ownership vacuum so abhorred in Anglo-American jurisprudence goes ignored in the hawala system. Understanding these points are key to grasping the inner workings of a very unique service.

Furthermore, it is important to separate the formal rules to hawala from those not necessarily intrinsic to it, namely the illegal methods that likely permeate the majority of the industry

¹⁶ Richard P. C. Brown, 'Migrant Remittances, Capital Flight, and Macroeconomic Imbalance in Sudan's Hidden Economy' (1992) 1(1) *Journal of African Economics* 86.

¹⁷ Samuel Munzele Maimbo, 'The money exchange dealers of Kabul: a study of the Hawala system in Afghanistan' *World Bank Working Paper Series: No. 13* (Washington DC, 2003)

<http://www.worldbank.org/external/default/WDSContentServer/WDSP/IB/2003/10/16/000090341_20031016085357/Renдерed/PDF/269720PAPER0Money0exchange0dealers.pdf> accessed 11 August 2015.

¹⁸ Nikos Passas, 'Demystifying Hawala: A Look into its Social Organization and Mechanics' (2006) 7 (Supplement 1) *Journal of Scandinavian Studies in Criminology and Crime Prevention* 46; James Risen, 'Intrigue in Karzai Family as an Afghan Era Closes' *New York Times* (New York, 4 June 2012) A1 <<http://www.nytimes.com/2012/06/04/world/asia/karzai-family-moves-to-protect-its-privilege.html>> accessed 23 December 2015; Adam B. Ellick and Dexter Filkins, 'Political Ties Shielded Bank in Afghanistan' *New York Times* (New York: 8 September 2010) A1

<<http://www.nytimes.com/2010/09/08/world/asia/08kabul.html>> accessed 23 December 2015; 'Kabul Bank fraud: Ghani reopens Afghan corruption case' BBC News (1 October 2014) <<http://www.bbc.com/news/world-asia-29450821>> accessed 23 December 2015.

¹⁹ Mohammad H. Kamali, *Principles of Islamic Jurisprudence* (ITS: London, 3rd edn 2002) 157-164.

today.²⁰Rather than whitewashing or treating these practices as mere aberrations, it is imperative to see them as part of a flawed system in a flawed world. Given the degree to which the hawala industry is simply non-compliant with basic regulatory procedures and banking laws in the United States, it should help in assessing the extent of the current problems facing the hawala industry and why reform and the law must become a greater concern to the hawaladars, the regulators and the general public.

3.1 The 'Nuts and Bolts' of a Hawala Transaction

In theory, hawala is very simple. The hawala system refers to a customary informal channel for transferring funds from one person to another via an independent broker or agent known as a hawaladar.²¹ The result is not all that different from Western Union or an ordinary bank draft cheque in that one party sends money to another, except that the hawaladar requires a corresponding independent hawaladar to complete the transaction at its destination and settle the account at a later date. No interest is paid on the accounts, since it is normally very short term and interest (*al-riba* ربا، الربوة / *in Arabic*) is *haram* in Islamic law and thus forbidden.²²

As long as there is a sender with some money for a distant receiver, the hawaladar will probably be able to find another hawaladar in close proximity to the latter and complete the transaction. Borders are rarely an obstacle. The hawala system relies heavily on trust, and it can take time to find someone to vouch for another hawaladar with whom he has no prior relationship. Mobile phones are the primary tool of these people. It may take him a few minutes or a few weeks, but they will eventually find a way through networking.

The most important aspect of the hawala network is the extent of personal relationships between hawaladars, as it provides a mechanism for bundling transactions between multiple hawaladars to balance accounts. Sometimes this bundling process is so efficient that no balance is ever exchanged amongst the middlemen; the outbound and inbound clientele of a hawaladar provide all the necessary liquidity and more or less balance out. If a more formal reconciliation is in order, it is done, but not always on the books. This will be discussed at greater length below. As such,

²⁰ Divya Sharma, 'Historical Traces of Hundi, Sociocultural Understanding, and Criminal Abuses of Hawala' (September 2006) 16 (2) International Criminal Justice Review 99-121.

²¹ Mohammed El-Qorchi, 'Hawala' (2002) 39 (4) *Finance and Development Magazine Quarterly* <<http://www.imf.org/external/pubs/ft/fandd/2002/12/elqorchi.htm>> accessed 23 December 2015.

²² Kamali (n 19).

the most intricate part of the hawala system is on the backend. Failures to make good on a deal are by most accounts extremely rare, and since they are already ‘off the books’, such instances are dealt with out of courts with either shunning or physical violence outside of places like Dubai where the industry operates with some level, however minimal, of regulation.²³

Fees are noticeably low and rarely discussed. Haggling is not an option to my knowledge. The commission on either end is factored into the receiving sum and rarely exceeds 1%.²⁴ Thrifty clients appreciate the value found in the hawala service, as most institutional money services business extract fees several times higher due to overhead such as brick and mortar facilities, commercial insurance, independent auditors, regulatory compliance costs and taxes (on the transaction or the income derived from the service) that are normally unknown to or simply ignored by the hawaladars.²⁵

There are also limits to the service provided by non-hawala remitters in certain markets. For example, although Western Union charges about 7% to wire money to Somalia, it can only send it to one office in the far north of the country. In a country where most of the population is too poor to afford even a camel, it is easy to see the attractiveness of hawala and why more mainstream services are unsatisfactory to anyone who is poor.²⁶

One of the more attractive aspects of hawala for consumers of certain regional origins is that it is convenient. Most hawaladars are available 24/7, reliable and almost hassle-free compared to their conventional rivals that extract higher fees and require multiple forms of photo identification.²⁷ Since local alternatives are so limited and can hardly be considered reputable by any objective measure, hawala has very limited competition in this type of environment where a weak and corrupt state combined with neglect by the international financial system has produced a rather moth-eaten financial sector.²⁸

²³ Meenakshi Ganguly, ‘A Banking System Built for Terrorism’ Time Magazine (5 October 2001)

<<http://content.time.com/time/world/article/0,8599,178227,00.html>> accessed 21 December 2015.

²⁴ Samuel Munzele Maimbo, *The Challenges of Regulating and Supervising the Hawaladars of Kabul, in Regulatory Frameworks for Hawala and other Remittance Systems* (International Monetary Fund: 2005) 47-52

<http://siteresources.worldbank.org/INTAFGHANISTAN/Resources/AFRFW_3_Challenges_of_Regulating_and_Supervising_Hawaladars.htm> accessed 21 December 2015.

²⁵ Anna Fifield, ‘How Iranians Are Avoiding Sanctions’ Financial Times (London, 14 April 2008),

<<http://www.ft.com/intl/cms/s/0/6ca69788-0a48-11dd-b5b1-0000779fd2ac.html#axzz2EmP2MaKm>> accessed 28 December 2015.

²⁶ Nicholas Kulish, ‘Somalis Face a Snag in Lifelines From Abroad’ New York Times (New York, 4 August 2013) A10.

²⁷ Organisation for Economic Co-Operation and Development (OECD), ‘Report on Money Laundering Typologies 1999-2000’ Financial Action Task Force FATF-XI (Paris, 3 February 2000) <http://www.oecd.org/fatf/pdf/TY2000_en.pdf> accessed 29 December 2015.

²⁸ Adil Anwar Daudi, ‘The Invisible Bank: Regulating the Hawala System in India, Pakistan and the United Arab Emirates’ (2005) 15 Indiana International & Comparative Law Review 619, 628-29.

3.2 Criminal Elements Embedded in the Hawala System

The administrative aspect of the backend is rather problematic at times- particularly for those that make no effort to operate legally. Licensed hawala enterprises based in the Persian Gulf or in the United States follow standard accounting practices, while most unlicensed hawaladars follow tradition and keep extremely shorthand (arguably coded in “thieves’ cant”²⁹) ledgers while some hawaladars simply go by memory, especially if illiterate.³⁰ These ledgers use unique abbreviations, rarely identify clients or consider the provenance of the funds in question.³¹ Part of this is a traditional part of the business, but today it serves to obscure the paper trail if anything attracts the attention of civil authorities in dodgy deals. Given that about 83% of the hawala industry is not registered or licensed, the overwhelming majority of hawala bookkeeping is essentially done Al Capone-style.³² Whether the style of hawala bookkeeping predates modern organized crime syndicates is anyone’s guess, but it remains useful to segments of the underground economy nonetheless.

Alternatively, ordinary financial institutions are used by hawaladars in the settlement and reconciliation process. Deposits are made into conventional western-style banks or channelled through regular money transmitters, but fragmented and wired to hundreds of banks around the world in a pattern known as the ‘starburst’. Sometimes, the money ends up in the account of origin to throw off audit trails in a technique referred to as the ‘boomerang’. Ardent defenders of hawala will reluctantly admit that the system is used to launder money and evade taxes because they are so well designed to work outside of the normal channels states use to track financial crime.³³ Even when employed for legitimate purposes, to diversify the risk involved in the transfer of large sums, hawaladars use techniques borrowed from criminal money launderers.³⁴

Other black market techniques utilised by professional money launderers and criminal syndicates are employed by hawaladars reconciling their accounts with others. Invoice fraud in international

²⁹ See Julie Coleman, *A History of Cant and Slang Dictionaries* (vol 1, 1567-1784 OUP 2004).

³⁰ Patrick M. Jost, Harjit Singh Sandhu, *Hawala: The Hawala Alternative Remittance System and its Role in Money Laundering* (FinCEN/INTERPOL Joint Publication, 2000) (Monograph), Appendix D 18.

³¹ Tina Susman, ‘Court cases shed light on money-transferring system’ Los Angeles Times (Los Angeles, 24 May 2010 <<http://articles.latimes.com/2010/may/24/nation/la-na-hawala-20100525>> accessed 22 December 2015: Stephen Hudak of the United States Treasury Department’s Financial Crimes Enforcement Network (FinCEN), which relies on bank alerts of suspicious activities to help track suspected illegal hawalas, stated concerning hawalas that, “They’re designed to be secretive, and they’re designed to have very little paper work involved. The record-keeping they do keep could be in another language.”

³² Abdulrahman Al-Khalifa, ‘The use of Hawala as a Remittance System’ *George Mason University Terrorism, Transnational Crime and Corruption Center* (TraCCC) <http://policy-tracc.gmu.edu/resources/publications/studentforum/Hawala_AR.pdf> accessed 19 December 2015.

³³ Ballard (n 15) 321.

³⁴ Kulish (n 26).

shipping is a common such tactic. One hawaladar will ship goods at a nominal value to avoid taxes and keep the deal under the radar of any preying authorities. EBay and other online sales systems provide an excellent medium for facilitating sham deals that appear legitimate barring extensive due diligence and incorporate a low-rate form of money exchange within the platform.³⁵ Shell companies are created with adequate funds or assets to settle balances and then transferred at nominal values to avoid scrutiny, taxes, fees and the like. Goods (both contraband and legitimate) are also sometimes smuggled to satisfy such accounts, chief among them gold and drugs.

It is important to note that in customary practice, it is normally a 'no questions asked' type of service. This is perhaps how hawala has earned its poor reputation among law enforcement and counterterrorism professionals. Even Swiss banks have effectively abandoned the 'I don't want to know' approach to banking.³⁶ Although there are licensed hawala businesses that comply with conventional customer due diligence and know-your-client best practices, the overwhelming majority are either ignorant of such things or wilfully ignorant. Sanctions are also rarely an obstacle.

As a matter of helping the books balance on both sides and encourage foreign exchange transfers through their system, hawaladars sometimes exempt expatriates from paying fees. In contrast, they reportedly charge higher fees to those who use the system to avoid exchange barriers, capital controls, the authorities or administrative hurdles.³⁷ Money leaving common destinations of transfers is also given preferable rates.³⁸

It is at this point that some commentators and authorities utilise special terminology to describe two separate patterns of hawala activity. 'White hawala' is used to describe ordinary money transfers, such as remittances and personal gifts, while 'black hawala' refers to black market deals handled by the hawala system involving drugs, frauds or terrorism.³⁹ There are several large,

³⁵ David Cook and Timothy Smith, 'The Malarkey of Money Transfers: Overlooking E-Bay whilst the Hawaladars are Hunted', Proceedings of the 1st Australian Counter Terrorism Conference (Edith Cowan University, Perth, Western Australia, 30 November 2010) <<http://ro.ecu.edu.au/cgi/viewcontent.cgi?article=1001&context=act>> accessed 31 Dec 2015.

³⁶ Foreign Account Tax Compliance Act (FATCA), Public Law 111–147, 124 Stat. 71 (2010); United States Department of the Treasury, 'Agreement Between the United States of America and Switzerland for Cooperation to Facilitate the Implementation of FATCA' (Press Release), (U.S.A.-Switzerland, 13 February 2013) <<http://www.treasury.gov/resource-center/tax-treaties/Documents/FATCA-Agreement-Switzerland-2-14-2013.pdf>> accessed 29 December 2015; also, see Jane G. Song, 'The End of Secret Swiss Accounts?: The Impact of the U.S. Foreign Account Tax Compliance Act (FATCA) on Switzerland's Status as a Haven for Offshore Accounts' (2015) 35 Northwestern Journal of International Law & Business 687 <<http://scholarlycommons.law.northwestern.edu/njilb/vol35/iss3/4>> accessed 21 December 2015.

³⁷ El-Qorchi (n 21).

³⁸ Ibid.

³⁹ Charles Falciglia, 'In Search of the Hawaladar' *ACAMS Today* (Miami, 29 August 2011) <<http://www.acamstoday.org/in-search-of-hawaladar/>> accessed 22 December 2015.

corporate hawala dealers operating in the United States and internationally, such as Amal and Dahabashiil that entirely deal in the ‘white hawala’ market, but as mentioned previously, very little of the hawala market operates legally licensed and regulated.⁴⁰ As such, even some of the ‘white hawala’ transactions are tainted a bit grey to some degree. They may also sit side by side in the dodgy ledgers with very ‘black’ transactions. It is also worth questioning whether nations have an obligation to root out and stop black market banking under international law.⁴¹ Given that terrorists and other unsavoury sorts operate in the space between nations, nations have a duty to helping maintain global security by providing a safe atmosphere for conducting business, although this is not well-defined in international law.

This sort of mixing of legitimate and illegitimate business potentially ties law-abiding consumers to criminals and terrorists unnecessarily. It is practices like these that should be avoided in the interests of the customers and the hawaladars themselves. Given that legal operation is distinctly possible, it should be sought. Such would blunt the criminal elements within the industry that has led it being a ‘banking system built for terrorism’⁴² that works in secrecy and deals with disputes mafia-style

IV. HAWALA AND THE LAW: LEGAL REQUIREMENTS AND CONSEQUENCES

In order to chart a better path for users and providers of hawala money services, it is imperative to understand the legal framework affecting it and the ‘Western’ counterparts in the market. Law and regulation is a challenging issue to all bank and financial services, and is constantly evolving due to endless scandals and pushback from the industry and its powerful political lobby. Also of great importance to this is the legal sanction associated with failure to adhere to the law.

Unlike that of some other countries, there is no general prohibition of hawala in the United States, nor for any other Islamic financial instruments and/or methods. Regulators and the law regard hawala as more of a brand than a separate financial system, so it does not play favourites over form rather than substance. But, as mentioned above, this has not encouraged many hawaladars

⁴⁰ Ibid.

⁴¹ Joel Slawotsky, ‘Partnering with Despots and Failed Regimes: Rogue Banking as a Primary Violation of International Law’ (2014) 16 (1) San Diego International Law Journal 73.

⁴² Ganguly (n 22).

to follow the law anyway except for some of the largest players in the business. Theory and good public policy might suggest this result is counterintuitive.⁴³

After all, shouldn't a fair and open marketplace automatically encourage compliance by its participants? Moreover, given the harsh fines and penalties notoriously associated with the American justice system, shouldn't compliance be a chief concern of every American hawaladar? Apparently not. Although the theory of financial accommodation suggests opening previously unrecognised practices and industries to official status should help incorporate previously marginalised activities to seek regulation, licensing and ensure consumer protections, there are several reasons why these results have not materialised. For starters, the law is not well publicized to certain immigrant communities. It is also difficult to enter the market, legally speaking, as there are several costly barriers entering the market.

4.1 Effects of Regulation on Non-Conforming Consumers and Remitters

As a type of Money Services Business (MSB) described by the Bank Secrecy Act (BSA), and more specifically as a type of money transmitter, all forms of IVTS may legally operate in any state or territory.⁴⁴ Financial regulators emphasize the result rather than the form of the business, unlike some other jurisdictions (namely India) that take a hard stance against hawala and other forms of IVTS more generally. There is no barrier to accessing the market for an individual or incorporated hawaladar so long as they abide by applicable state and federal laws governing the conduct and operation of business.

More importantly though, banks and money transmitters in the United States are heavily regulated in terms of their record keeping and which ones must be disclosed to the government.⁴⁵ There are also rules and regulations regarding what documentation individuals must have in order to do business with banks that were heavily revised under the USA PATRIOT Act following 9/11.⁴⁶ There are potentially very large civil and criminal penalties for failing to register with

⁴³ Jonathan Ercanbrack, *The Transformation of Islamic Law in Global Financial Markets* (Cambridge University Press, 2015) 149.

⁴⁴ Bank Secrecy Act, Public Law 91-508 (1970) (codified as amended in various sections of Titles 12, 15, and 31 of the United States Code).

⁴⁵ 31 U.S.C. §§ 5313, 5316.

⁴⁶ USA PATRIOT Act, Public Law 107-56 (2001) (amending the following: Title III, Subtitle C, §§ 328, 330, 352-354, 359-365, 371, 372, 374, 18 U.S.C. §§ 1956, 1960, 1961, 31 U.S.C. §§ 5311 - 5313, 5317 – 5319, 5321, 5322, 5324, 5330-5332 and 5341).

FinCEN and failure to comply with the necessary recordkeeping, financial reporting, anti-money laundering and counter terror finance requirements.⁴⁷

As mentioned above, the overwhelming majority of hawaladars are not registered with FinCEN or in line with these expectations. Granted, most money transfer businesses operate without licenses according to national authorities.⁴⁸ But hawala services are especially non-compliant, with less than 20% seeking and obtaining requisite licensing and registration. To put it bluntly, they risk prosecution regardless of whether their hawala services are part-time humanitarian endeavours or vast criminal conspiracies.⁴⁹ Generally speaking, the law does not care. Worse yet, an aggressive prosecution case can convince a jury of the latter anyway simply thanks to the nature of hawala bookkeeping- it is intentionally deceptive by design, which is normally considered proof of criminal wrongdoing regardless of any explanation by the defendant.⁵⁰

One thing that FinCEN does as a national financial intelligence unit is report regularly on their efforts at enforcing laws and regulations. As an arm of the US Treasury Department, it does this partly out of vainglory and partly out of statutory obligation to keep open records for the public regarding its often newsworthy work.⁵¹ Another office within the Treasury, the Office of Foreign Asset Control (OFAC), has a similar gimmick, but involving sanctions.⁵² Hawala makes up very little of this reporting and accounts for a tiny fraction of FinCEN's caseload, but incidents of off-the-books hawala rarely end well nonetheless.

⁴⁷ 18 U.S.C. § 1960; 31 U.S.C. § 5330.

⁴⁸ United States Government Accountability Office, 'Bank Secrecy Act: FinCEN and IRS Need to Improve and Better Coordinate Compliance and Data Management Efforts' (Washington, DC, GAO Report to Congress No. 07-212, 15 December 2006) 11-12 <<http://www.gao.gov/assets/260/254590.pdf>> accessed 21 March 2016.

⁴⁹ *United States v Ahmad* 213 F.3d 805 (4th Cir. 2000); *United States v Ismail* 97 F.3d 50 (4th Cir. 1996).

⁵⁰ *United States v X-Citement Video Inc.* 513 U.S. 64 (1994) 68 (Supreme Court); *Liparota v United States* 471 U.S. 419 (1985) 426 (Supreme Court); *Bailey v United States* 516 U.S. 137 (1995) 144-145 (Supreme Court); Christopher R. Chase, 'To Shred or Not to Shred: Document Retention Policies and Federal Obstruction of Justice Statutes' (2003) 8(3) Fordham Journal of Corporate and Financial Law 721.

⁵¹ United States Department of the Treasury: Financial Crimes Enforcement Network (FinCEN), 'Retail Store Owner Sentenced for Unlicensed Hawala Operation' *The SAR Activity Review – Trends, Tips & Issues* (Issue 8, April 2005) <http://www.fincen.gov/law_enforcement/ss/html/056.html> accessed on 19 April 2015; United States Department of the Treasury: Financial Crimes Enforcement Network (FinCEN), 'Illicit Wire Activity Destined for Sanctioned Country' *The SAR Activity Review – Trends, Tips & Issues*, (Issue 18, October 2010) <https://www.fincen.gov/law_enforcement/ss/html/Issue%2018-story%208.html> accessed 26 December 2015; also, as such reports are numerous and not sorted by subject headers, see more generally *The SAR Activity Review – Trends, Tips & Issues* Archive compiled by the FinCEN, a section of the United States Department of the Treasury at <https://www.fincen.gov/news_room/rp/sar_tti.html>.

⁵² United States Department of the Treasury Press Center, 'Treasury Department Sanctions a Taliban Funding Conduit and Two Key Taliban Figures: Action Targets a Pakistan-based Hawala, Hawaladar and one Taliban Commander' 21 August 2014 <<https://www.treasury.gov/press-center/press-releases/Pages/jl2612.aspx>> accessed 26 December 2015; United States Department of the Treasury Press Center, 'Treasury Imposes Sanctions on a Hawala and Two Individuals Linked to the Taliban' 20 November 2012 <<https://www.treasury.gov/press-center/press-releases/Pages/tg1777.aspx>> accessed 26 December 2015; also, see *United States v Banki* 660 F.3d 665 (2d Cir. 2011).

Even for hawaladars not actively working as terror financiers, noncompliance can mean prison time and serious financial penalties. Such was the case of *United States v. Elfgeeh*, also known as the *Carnival Ice Cream Case*, since it involved a small ice cream shop in Brooklyn, New York that operated a \$21 million unlicensed hawala business on the side.⁵³ Two brothers were responsible for the hawala business. They used many techniques of money launderers to obscure their activities. It never made a profit and claimed to operate out of charity to the local Yemeni immigrant community with limited remittance options. They were notified by state and federal regulators of their registration and licensing obligations, but neglected warnings as they did not consider themselves to be a ‘business’ since they made no profit.⁵⁴ Some of the funds they handled, however, were delivered to individuals tied to Al-Qaeda and its front groups; although no proof was presented that the hawaladars knew of this or had any way to discover it. Both men received lengthy prison terms, one for 51 months and the other 188.⁵⁵

Although it might not seem like it, *Elfgeeh* was a landmark case as it was the first successful prosecution of an unlicensed hawala business and only the second involving an unlicensed money transfer business to go to federal trial in the United States.⁵⁶ More importantly, it was one of the first cases following the oft-maligned USA PATRIOT Act and its numerous changes to the United States Code.⁵⁷ Prior to the USA PATRIOT Act, 18 U.S.C. § 1960(a) required that an individual have knowledge of licensing laws and regulations *and* intent to violate them, making prosecution of hawaladars nearly impossible. The USA PATRIOT Act removed the intent requirement. The case established an important new test under § 1960(a), deciding that knowledge of an MSB merely being unlicensed was sufficient for conviction.⁵⁸ Subsequently, there have been numerous cases involving money laundering and hawala, many of which have allegations of terrorist financing at the heart of them.⁵⁹

⁵³ *United States v Elfgeeh* 515 F.3d 100 (2d Cir. 2008) (Appellate Court Decision) aka ‘the Carnival Ice Cream Shop Case.’

⁵⁴ In terms of United States company and tax law, non-profit companies are expressly permitted under the Internal Revenue Code, 26 U.S.C. §§501-530; see Bruce R. Hopkins, *The Law of Tax-Exempt Organizations* (New York: John Wiley and Sons 10 Ed., 2011) 879.

⁵⁵ *Elfgeeh* (n 53).

⁵⁶ *United States v Velastegui* 199 F.3d 590 (2d Cir. 1999); Due to the prevalent custom of plea bargaining and deferred prosecution agreements in the United States, approximately 95% of cases never actually go to trial.

⁵⁷ USA PATRIOT Act, Public Law 107-56 (2001) (n 41).

⁵⁸ *Elfgeeh* (n 53), 132; *United States v Elfgeeh* No. CR-03-0133 (E.D.N.Y. 20 September 2005) (Trial Court); 18 U.S.C. § 1960(a).

⁵⁹ *United States v El-Mezain* 664 F.3d 467 (5th Cir. 2011); *United States v Yassin Muhiddin Aref and Mohammed Mosharref Hossain* Unreported, Criminal Action No. 04-CR-402, (N.D.N.Y.; Sentencing Memorandum: 29 January 2007, Court Transcript: 8 March 2007; *United States v Uddin* 365 F. Supp.2d 825 (E.D. Mich. 2005); *Holy Land Foundation for Relief and Development v Ashcroft* 219 F. Supp. 2d 57 (D.D.C. 2002), aff'd, 333 F.3d 156 (D.C. Cir. 2003), cert. denied, 540 U.S. 1218 (2004); *United States v Bayan Elashi, Ghassan Elashi, Basman Elashi, Infocom Corporation* 440 F. Supp. 2d 536 (N.D. Texas 17 December 2006).

Outside of the hawaladars, some hawala customers may also be subject to prosecution for using unlicensed hawaladars even in otherwise legal transactions. One such case, *United States v Banki*, involved an affluent Iranian-American transferring family money stateside from Iran by way of an unlicensed hawala business in Dubai with access to an American bank account.⁶⁰ Given the extremely complex sanctions programme in place between the United States and Iran, most business deals and transactions between nationals of the two countries are prohibited.⁶¹ Mahmoud Banki was tried for several sanctions violations and most notably for contravening 18 U.S.C. § 1960(a):

Whoever knowingly conducts, controls, manages, supervises, *directs*, or owns all or part of an unlicensed money transmitting business, shall be fined in accordance with this title or imprisoned not more than 5 years, or both.

The case against him rested on the fact that as the customer, he was ‘directing’ an unlicensed MSB enterprise and a transaction that would have required a special license from OFAC. The jury, however, was not instructed to consider an explicit exemption for both the licensure and sanctions regarding transfers of family assets in the Code of Federal Regulations.⁶² The exemption in question is wide enough in scope that it should have led to a summary dismissal of charges at the trial stage, but the motion was denied. He was convicted and sentenced to a prison term of 30 months.

Banki is presently regarded as something of a prosecutorial error bordering on an Islamophobic witch hunt. Many notable supporters came to Mahmoud Banki’s defence, including a former director of OFAC who went to great lengths to explain the errors in the US Attorney’s case and the judge’s application of the law. Although the initial case was successful, the conviction was overturned on appeal due to the grievous jury misdirection and all charges were subsequently dropped. Banki spent 22 months in prison before being released. That being said, the legal consequence of using such a system as a mere customer or beneficiary to an unlicensed hawala transaction was not actually addressed by the Circuit Court of Appeals for the Second District in

⁶⁰ *United States v Banki* 660 F.3d 665 (2d Cir. 2011).

⁶¹ See Kian Arash Meshkat, *The Burden of Economic Sanctions on Iranian-Americans* (2013) 44 Georgetown Journal of International Law 915.

⁶² 31 C.F.R. § 560.550.

Banki. In essence, this point of law remains open due to a procedural technicality and prosecutorial discretion.

Of important note in this are civil penalties upon successful conviction, specifically relating to the civil asset forfeiture. The consequences are exceptionally high, as U.S.C. § 1960 is a “specified unlawful activity” that the government can forfeit any property, real or personal, which constitutes or is derived from any traceable proceeds.⁶³ The United States has peculiar civil asset forfeiture laws that put the property in question on trial, but deny it counsel or the right to be represented in proceedings, even by the individual in question. This results in a variety of strange case names.⁶⁴ It is arguably a summary revocation of due process and rights to property. But that does not detract from the main point, which is that any outlaw hawaladar will likely face complete financial ruin and disgorgement by federal authorities upon conviction. The price of noncompliance is exceptionally high.

In summary, consequences for operating, participating in and using unlicensed hawala MSBs are potentially very high. But as noted, this can easily be avoided by conforming to legal and regulatory expectations of the industry that are not so onerous as to preclude participation from most already in the hawala business. Given the potential cost of noncompliance, explaining the procedures and processes of entering the market lawfully must be communicated better. It is my hope to some extent that the following will serve as a better introduction regarding the relevant statutes, regulations, licenses and processes that apply to such people and enterprises.

4.2 Federal Registration and Regulatory Requirements for the Hawala Industry

Navigating the regulatory state is normally cited as being the leading obstacle that small to medium sized businesses face.⁶⁵ Hawaladars are in all likelihood no different, as stiff penalties and a complicated regulation system *de facto* keep the overwhelming majority of them in the

⁶³ 18 U.S.C. § 981(a)(1)(A-C); *United States v Huber* 404 F.3d 1047 (8th Cir. 2005) 1056-57; Jon E. Gordon, *Prosecutors Who Seize Too Much and the Theories They Love: Money Laundering, Facilitation, and Forfeiture* (1995) 44 Duke Law Journal 744, 770-71; Stefan D. Cassella, *The Forfeiture of Property Involved in Money Laundering Offenses* (2004) 7 Buffalo Criminal Law Review 583, 585ff.

⁶⁴ *United States v Approximately \$44,888.35 in U.S. Currency* 385 F. Supp. 2d 1057 (E.D. Cal. 2005); *United States v 47 10-Ounce Gold Bars, etc.* 2005 WL 221259 *1 (D. Or. 2005); *United States v \$734,578.82 286 F.3d 641* (3d Cir. 2003), 650-53; *United States v \$8,221,877.16 in U.S. Currency* 330 F.3d 141 (3d Cir. 2003); *United States v All Funds on Deposit in the Name of Kahn* 955 F. Supp. 23 (E.D.N.Y. 1997); *United States v Real Property 874 Gartel Drive* 79 F.3d 918 (9th Cir. 1996); *United States v \$20,193.39 U.S. Currency* 16 F.3d 344 (9th Cir. 1994), 346; *United States v 1988 Oldsmobile Cutlass Supreme* 983 F.2d 670 (5th Cir. 1993).

⁶⁵ Dennis Jacobe, ‘Gov’t Regulations at Top of Small-Business Owners’ Problem List’, Gallup Inc. (24 October 2011) <<http://www.gallup.com/poll/150287/gov-regulations-top-small-business-owners-problem-list.aspx>> accessed 31 December 2015.

underground economy. Coming into compliance is not easy. The following will hopefully assist in some sense in understanding the regulatory expectation hawaladars face conducting their businesses in the United States, and more specifically in New York.

Due to the doctrine of dual sovereignty in American Federalism, there are overlapping regulatory responsibilities between states and the federal government. This article will only discuss the law as it applies in the state New York and at the federal level. The Federal approach to combatting money laundering in this political arrangement led to placing the licensing onus on respective states.⁶⁶

The legal status in New York is of utmost importance, primarily because that is epicentre of the American financial system, but also because the author is based there. The legal system of New York is considered to be the most important since it leads the nation in many ways, specifically banking law, and many other states follow its lead by adopting provisions first promulgated here. Its judiciary is also held in high regard both nationally and abroad.⁶⁷

It is important here to highlight the difference between registration and licensing, as each is sought by different levels of civil authorities in the United States. Registration processes require fewer conditions to be fulfilled at the time of entry, thus making it easier to enter the market. Licensing is much more difficult process though, as these involve proving and establishing certain conditions for licensure in addition to front-end screening of applicants. As a result, registration processes are less onerous, while extensive review and ongoing supervision are necessary for licensing programs. As a rule, the federal government pursues registration while state authorities license MSBs. Both, however, create a framework for the supervision of who can operate an MSB and ensure their compliance with anti-money laundering and counter terror finance obligations.

At the federal level, those performing hawala services are subject to a number of conditions to operate legally. First among these requirements is that all hawala businesses register with FinCEN using Form 107, which all MSBs are required to complete.⁶⁸ It must also obtain a state license. This registration must be renewed every two years. Failing to register or renew with FinCEN can result

⁶⁶ See, Courtney J. Linn, ‘One-hour Money Laundering Prosecuting Unlicensed Money Transmitting Businesses Under 18 U.S.C. § 1960’ (2007) 8 University of California- Davis Business Law Journal 138.

⁶⁷ For much of the “Roaring Twenties”, Benjamin Cardozo headed the state’s unified judiciary as chief judge of the New York Court of Appeal and many considered his appointment to the United States Supreme Court in 1932 as something of a demotion.

⁶⁸ Form 107 is available via the e-file system at <<http://bsaefiling.fincen.treas.gov/main.html>> accessed 4 January 2016; 31 U.S.C. s 5330 and 31 C.F.R. § 103.41; see 31 C.F.R. § 103.11(u) for the definition of ‘money service business’ which is defined very broadly.

in large civil and criminal penalties like those detailed above.⁶⁹ This is probably one of the simplest things hawala businesses can do to stave off scrutiny from the authorities and avoid consequences, but almost none ever do this much. Importantly, there is no excuse for failing to register with FinCEN or obtain a state license.⁷⁰

After this, a hawala business is required to familiarize itself with potential risks it faces in terms of money laundering and create a set of policies and procedures to limit the abuse of their services by criminals and then to produce a written plan of action.⁷¹ This can include asking questions and investigating about the source and destination of the funds, profiling clients based on the backgrounds depending on the circumstances. The program need not be as detailed and involved as that of major MSBs, but needs to fit the business' needs.

This is part of a larger goal all financial services providers and banks must operate under in terms of complying with anti-money laundering and counter-terrorist financing provisions of the Bank Secrecy Act, the USA PATRIOT Act and other relevant legislation.⁷² There is no single answer to going about this challenge, and there is a wide margin of appreciation for its implementation, again, depending on the risk exposure of the particular hawala business.⁷³

Accordingly, a number of special measures exist to comply with minimising criminal risk exposure. MSBs must file SARs if a transaction over \$2000 appears to have no business purpose or seems is suspicious enough to warrant further investigation.⁷⁴ Needless to say, knowingly providing of material support to a terrorist or to a designated terrorist organisation is a serious problem, so MSBs are required to go the extra step to make sure their operations are not conduits for the laundering of money funding terrorism.⁷⁵

⁶⁹ 31 C.F.R. s 103.41(e).

⁷⁰ *United States v Barre* 324 F. Supp. 2d 1173 (D. Colo. 2004) 1177.

⁷¹ 31 C.F.R. s 103.125; 31 C.F.R. s 1022.210.

⁷² United States Department of the Treasury, *A Report to the Congress in Accordance with Section 359 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act)* (November 2002) 6-15 <http://www.fincen.gov/news_room/rp/files/hawalarptfinal11222002.pdf> accessed 21 April 2016; Money Laundering Suppression Act of 1994 (Title IV of the Riegle Community Development and Regulatory Improvement Act of 1994), Public Law 103-325 (1994); Bank Secrecy Act, Public Law 91-508 (1970) (codified as amended in various sections of Titles 12, 15, and 31 of the U.S. Code); USA PATRIOT Act, Public Law 107-56 (2001), (Title III, Subtitle C, § 359 amended 31 U.S.C. s 5330(d)(1)(A))

⁷³ For more information, free resources are available from FinCEN's 'Requirements for BSA' site at <https://www.fincen.gov/financial_institutions/msb/msbrequirements.html> accessed 4 January 2016; also, see *FATF Guidance on the Risk-Based Approach for Money Services Businesses*, Financial Action Task Force Report (July 2009) <<http://www.fatf-gafi.org/media/fatf/documents/reports/RBA%20Guidance%20for%20Money%20Service%20Businesses.pdf>> accessed 23 December 2015.

⁷⁴ 31 C.F.R. s 103.20.

⁷⁵ 18 U.S.C. s 2339A, 2339B; *United States v Hammoud* No. 3:00CR147-MU (W.D. N.C. 28 March 2001); *United States v Abdi* 342 F.3d 313 (4th Cir. 2003)

Also as a result, all MSBs, including those that could be characterized as IVTS, must obtain and verify customer identity and record beneficiary information for funds transfers of more than \$3,000.⁷⁶ There are also separate record keeping requirements applicable to the sale of MSB products, such as traveller's checks and money orders, as well as to currency exchange transactions.⁷⁷ These records must be maintained for five years.⁷⁸

Aside from these strict record keeping requirements are in place under the Bank Secrecy which include geographical targeting orders (GTOs). These GTOs require strict reports and records regarding services rendered to specified geographical areas and certain persons therein for limited periods of time.⁷⁹

Since hawala provides an opportunity to circumvent two legally required reporting requirements designed to catch money laundering, it is important to put these at the front of the compliance programme. The first is to report all cash transactions over \$10,000.⁸⁰ The second is to report any transfer of more than \$10,000 (cash or otherwise) to another country.⁸¹ The filing of these special 'Suspicious Activity Reports' (SAR) is done through the same e-filing system mentioned above and requires a specific style of information gathering that is designed to assist law enforcement with following up.⁸² They should be done within 30 days. Even if the client is deemed to be guiltless upon further investigation, an SAR must still be filed, although it can listed as a matter of low-concern in the profile.

A common misperception is that the Internal Revenue Service, Department of the Treasury and, more specifically, FinCEN require all MSBs to retain expensive outside auditors for independent tests of both their bookkeeping and an anti-money laundering programme. This is not correct, although MSBs do need to keep these records for several years.⁸³ Although reviews and audits are important, they are not formally required so long as the books and money laundering programme remain in order, up to date and subject to periodic review by the relevant management.⁸⁴ This is especially advantageous to independent and smaller MSBs that may not be

⁷⁶ 31 C.F.R. s 103.33(f).

⁷⁷ 31 C.F.R. s 103.29; 31 C.F.R., s 103.37.

⁷⁸ 31 C.F.R. s 103.38.

⁷⁹ 31 C.F.R. s 103.26.

⁸⁰ 31 U.S.C. s 5313; 31 C.F.R., s 1010.311.

⁸¹ 31 U.S.C. s 5316; 31 C.F.R., s 1010.100.

⁸² For more information, see *Financial Crimes Enforcement Network Suspicious Activity Report (FinCEN SAR) Electronic Filing Instructions*, United States Department of the Treasury: Financial Crimes Enforcement Network (FinCEN) (Washington, D.C., October 2012) <<https://www.fincen.gov/forms/files/FinCEN%20SAR%20ElectronicFilingInstructions-%20Stand%20Alone%20doc.pdf>> accessed 29 December 2015.

⁸³ 31 C.F.R. s 1010.430.

⁸⁴ 31 C.F.R. s 103.125; 67 Fed. Reg. 21114 (29 Apr 2002).

financially able to hire retain outside auditors. An excellent resource for keeping abreast of a changing regulatory landscape is provided to members of the National Money Transmitters Association.⁸⁵ Simply remaining commercially aware of potential abuses of the business by black market actors and new regulatory requirements can avoid unwanted litigation.

Another means of achieving better compliance and a chief recommendation regarding federal regulatory requirements is not a formal requirement and more of an optional ‘get out of jail free card’. Section 314(b) of the USA PATRIOT Act allows financial institutions and MSBs to share information for the purposes of reporting money laundering and terrorist financing upon providing notice to FinCEN under protection of legal safe harbour.⁸⁶ This section in some ways deputizes those in the program, and limits their liability regarding customer information privacy and for known cases of money laundering and terrorist finance so long as a good faith effort has been made to build a working reporting system. Participation may not be mandatory, but failing to take advantage of 314(b) is, simply put, irresponsible from a business perspective.

4.3 Licensing and Regulatory Requirements for Hawala in New York State

New York state law differs in many significant ways from the approach of the federal government in how it regulates MSBs. In New York, it is illegal to receive money for transmission, or to transmit money without a license issued by the Superintendent of Financial Services. The Superintendent heads the New York State Department of Financial Services, which is charged with implementing all state banking laws, including those pertaining to MSBs.⁸⁷

Money transmitters are covered under Article XIII-B of the New York State Banking Law, and include a wide array of product lines including traveller’s cheque vendors and cheque cashing services. Licensed MSBs may employ agents who do not require a license for most of their functions so long as they handle their accounts through licensed transmitter, although they must be supervised and conform to all applicable laws.⁸⁸ Operation of an unlicensed MSB can be either a felony or misdemeanour, and as such raises the potential for federal criminal penalties under 18 U.S.C. § 1960. There is only one possible exception to this rule, and that is the United States Postal Service, which does provide some money transfer services and enjoys a unique position in the

⁸⁵ The National Money Transmitters Association website <<https://nmta.memberclicks.net/>> accessed 2 January 2016.

⁸⁶ USA PATRIOT Act s 314(b), implemented by 31 C.F.R., s 103.110, available to MSBs through 31 C.F.R., s 103.125.

⁸⁷ N.Y. Banking Law, ss 11-12(a), s 14, s 641.

⁸⁸ N.Y. Banking Law, ss 648(a-c), s 651(a); 3 N.Y. Comp. Codes R. & Regs, s 406.5(a)(6).

market and law by virtue of being a federal agency established under the United States Constitution.

Getting a license in New York is not a straightforward process. Detailed instructions for the application are available.⁸⁹ Amazingly, New York State has not yet developed the convenient and completely digital type of portal that FinCEN, as the application for an MSB license can be found here and is only available in paper form and must be submitted by mail.⁹⁰ The process requires a detailed background check of all principals and corporate officers to be conducted by a licensed private detective at company expense and sent with the application. Further information for investigation by the Superintendent is also required, including histories of legal proceedings, financial dealings and details of the business structure listing all ultimate beneficial owners. The license costs US\$3,000. License applicants must also complete notarised affidavits regarding their knowledge and acceptance of numerous orders made regarding freezing terrorist assets and customer information privacy. Licenses are transferable, but the objects of such transfers are subject to detailed background checks by the Superintendent, just like for initial applicants.⁹¹

The anti-money laundering provisions under New York state law are comparable to that at the federal level, including the requirement to have designated staff in charge of developing the programme and file SARs.⁹² These effectively mirror federal law, particularly those found in the Bank Secrecy Act, in substance and form.⁹³ This is intentional, and most states follow a similar legal path in harmonising AML/KYC/CDD programme expectations with federal authorities. Ongoing money laundering training is required for staff, and the appointment of a responsible compliance officer with a minimum of three years experience is required.

Meticulous bookkeeping is required by state law. All records are subject to inspection by the Superintendent and subordinate agents on demand and must be kept for a minimum period that, depending on the size of the transaction, can range from six months to five years.⁹⁴ All MSBs,

⁸⁹ *Instructions: Transmitter of Money License*, New York State Department of Financial Services, <<http://www.dfs.ny.gov/banking/ialfmti.htm>> accessed 4 January 2016.

⁹⁰ *Application for a License to Engage in the Business of Issuing Travellers Checks, Money Orders, Prepaid/ Stored Value Cards and/or Transmitting Money*, New York State Department of Financial Services, (DFSMR Rev 10.03.2011) <<http://www.dfs.ny.gov/banking/ialfmta.pdf>> accessed 4 January 2016.

⁹¹ N.Y. Banking Law, s 652(a); s 3 N.Y. Comp. Codes R. & Regs., s 406.11.

⁹² 3 N.Y. Comp. Codes R. & Regs., s 417.2.

⁹³ 3 N.Y. Comp. Codes R. & Regs., ss 406.2(a), s 406.9, s 416.1; s 31 C.F.R., s 103.28.

⁹⁴ N.Y. Banking Law s 39 (6); 3 N.Y. Comp. Codes R. & Regs., s 406.7.

including hawala businesses, are subject to detailed quarterly reports on their revenues, changes in operations and must further voluntarily report any misconduct within 45 days of the event.⁹⁵

The continued operation of an MSB in good standing requires that all licensed MSBs acquire deposit/surety bond to protect customers in case the business goes into liquidation.⁹⁶ The precise costs for coverage vary widely, but are necessary for the protection of consumers who deposit funds into an account in good faith of performance. Private surety can be acquired on the open market, or alternatively it can be obtained from the Federal Deposit Insurance Corporation in some circumstances. Alternative to the surety bond, the principals may put up an independent security bond in an escrow account, subject to approval by the Superintendent.⁹⁷ Following industry best practice, the amount required would need to be close to 10% (at least) of the businesses quarterly receipts. The state also has specific provisions to provide for such surety if no alternative is made under Title XIII-C of the New York State Banking Law.⁹⁸ Given that many such businesses cannot obtain surety due to low overhead, limited market access, or participant risk, an alternative fund was created by statute. In these cases where alternative means of surety or insurance bonding is not achieved, a penalty or fee of 2% is levied on all transfers handled by the MSB, the total amount being capped at \$125,000 per year.⁹⁹ These fines go to the ‘state transmitter money fund’. It is supposed to act in cases of insolvency, bankruptcy or inability to pay and will be capitalised enough to handle all customer claims in such an event.

Licenses can be revoked for any infractions by the Superintendent following a hearing.¹⁰⁰ No warnings are necessary and the rights of appeal, although subject to judicial review, are highly unlikely to be successful if evidence for cause is established.¹⁰¹ The system permits very little leniency after a decision has been made regarding termination of licenses.

V. REFORMS TO BRING HAWALA REGULATION INTO THE 21ST CENTURY

As is apparent by now, the present status quo of hawala in the eyes of the law and the marketplace is that it is an outlaw industry. The overwhelming majority of the industry is unlicensed and

⁹⁵ 3 N.Y. Comp. Codes R. & Regs. s 406.10.

⁹⁶ N.Y. Banking Law, ss 641-643; 3 N.Y. Comp. Codes R. & Regs., s 406.13(a-b).

⁹⁷ N.Y. Banking Law s 643(3); 3 N.Y. Comp. Codes R. & Regs., s 406.14.

⁹⁸ N.Y. Banking Law, Title XIII-C, ss 653-659.

⁹⁹ N.Y. Banking Law s 657; 3 N.Y. Comp. Codes R. & Regs., s 406.15.

¹⁰⁰ N.Y. Banking Law, s 642; 3 N.Y. Comp. Codes R. & Regs., s 406.8.

¹⁰¹ N.Y. Banking Law, s 647.

operates illegally. Extremely steep fines and prison sentences are doled out. Consumers are not afforded protections offered elsewhere in the marketplace, creating a second-class customer. It is a situation in which no one wins and it limps along by choice of both the hawaladars and legislators who have no impetus to ever change it. Many reforms are needed, and it is simply not realistic to expect conformity from a uniquely decentralised financial service such as hawala.¹⁰² Given the *sui generis* small-market position, cultural affinity and traditional nature of hawala (and certain other IVTS systems for that matter), some special treatment is warranted.

It is apparent that regulating a customary, low cost and very basic banking service like a modern equivalent is not working. A new regulatory approach is needed. As noted above, while the cost of complying with federal registration procedures is low, state licensing is prohibitively expensive for all but the wealthiest of hawaladars. Barriers to entering the market exist that lock out all but the already well-heeled. It is in this way that the United States and its regulatory state mirror the corrupt regimes of the ‘Global South’ that over-regulate and tax everything the underprivileged have into the underground economy. This is how Osama Bin Laden was able to finance his terror so easily, after all, the blame of the potential hawaladars is incidental in this regard.

As such, a new strategy would behove the regulators in dealing with the hawala industry. Between the licensing fee, incidental costs like background investigations and hefty surety bond, the regulatory state effectively acts as a barrier to entry. A lower license fee needs to be available to hawala businesses and be combined with a separate surety pay-as-you-go surety fund. In effect, a parallel regulatory and surety scheme is necessary.

A necessary feature of this parallel system would be best practice guidance on anti-money laundering and customer due diligence programmes. As it is, these are nebulous and difficult to quantify in many respects for ordinary banking and financial services institutions. The current anti-money laundering and customer due diligence standards in place are extremely vague to the point that they create excessive false red flags. In this way, wealthier countries need to target the anti-money laundering regulations with greater precision. The Organisation for Economic Co-Operation and Development and the Financial Action Task Force need to specify in great detail specifically what makes transactions high-risk and banks need assurances that they will not be prosecuted for the actions of clients when they stick to the more clearly defined standards and

¹⁰²Smriti S. Nakhsi, ‘Western Unionizing the Hawala: The Privatization of Hawalas and Lender Liability’ [2006-2007] Northwestern Journal of International Law and Business 475.

report criminal activity appropriately. Technology (particularly telecommunications) and global diasporas have made hawala much more competitive and needed, but our current regulation paradigm has proven an obstacle.

Finally, a general amnesty for existing hawala businesses must be extended. A promise of prosecutorial immunity for past unlicensed hawala activity can reasonably be offered under the condition of future compliance. Coupled with an outreach effort to the communities most reliant on their services, this would incentivise those non-compliant hawaladars to leave the grey market and enter the parallel regulatory system. They would also suddenly be on the tax rolls and on the radar of the national financial intelligence unit, FinCEN.

VI. CONCLUSION

Just like a river, commerce will follow the path of a least resistance in a free market. In the era of hyper-globalisation, this route will tell an incredible story about human geography. Hawala is just one of many no doubt, but its present channel is beset by many hurdles. The Organisation for Economic Co-Operation and Development's Financial Action Task Force has noted that hawala has remained popular it usually costs less than moving funds through other means, operates 24/7, is more reliable, and requires minimal paperwork.¹⁰³ The present status of hawala regulation in New York and the whole United States is really untenable in its present form. It fails to recognise the independent nature of the business, the communities it caters to, and regions which most frequently rely on it for basic things like remittances. The present policy of denying pluralism is not working. If it were, fewer hawaladars would be exposing themselves to criminal prosecution.

Hawala occupies a unique place in the history and the commercial culture of the Middle East and North Africa even to this day. And although the past century has brought more change to the region than the preceding twenty combined, hawala remains much as it was at its inception: a simple money transfer system dependent upon non-competitive brokers. Although representing a tiny slice of the global transfer business, it makes up a large proportion of the business in key markets and demographics both within the region and worldwide, namely in underdeveloped

¹⁰³ OECD (n 26).

countries and their diaspora communities that use hawala as a lifeline for remittances. It is for this reason that it is of great importance.

In spite of its unique origins and niche market, domestic regulators (to their credit in all fairness) look to substance rather than form in the application of existing laws. If there is one thing this article should testify to, it is that the measures imposed on larger market participants in the MSB business are simply not scalable to either the hawaladars or their customers. It is a problem of the system being designed for economies of scale instead of small businesses, an all too common within the American system of government these days.

As such, it is important to consider potential remedies capable of fixing key problems affecting the hawala industry. Some 80% of hawaladars are not in compliance with licensing, taxation, and anti-money laundering requirements. Some are simply ignorant of the law and others have no means of complying given the hurdles in place for highly profitable players such as Western Union and large international banks. Rather than relying on the law as a cudgel to compel obedience, better outreach and an alternative regulatory system as loosely outlined above would better serve the interests of both the hawala industry and the government in creating a more open, transparent and ethical money transfer industry that is free from abuse by criminal elements.

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