



**Financial Action Task Force
on Money Laundering**
Groupe d'action financière
sur le blanchiment de capitaux

**COMBATING THE ABUSE OF
ALTERNATIVE REMITTANCE SYSTEMS:
International Best Practices**

Please note that this document refers to the FATF Recommendations as last updated and published in October 2004, and does not yet take into account the 2012 revision of the FATF Recommendations.

See www.fatf-gafi.org/recommendations for the 2012 FATF Recommendations, including the conversion table from the old Recommendation to the new FATF Recommendation.

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COMBATING THE ABUSE OF ALTERNATIVE REMITTANCE SYSTEMS

*International Best Practices*¹

Introduction

1. Alternative remittance systems are financial services, traditionally operating outside the conventional financial sector, where value or funds are moved from one geographic location to another.

Special Recommendation VI: Alternative Remittance²

Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.

2. While the Interpretative Note is intended to further explain Special Recommendation VI, the Best Practices Paper is intended to give additional details (including some examples), to offer jurisdictions suggestions in implementing Special Recommendation VI and to give them guidance on how to detect alternative remittance systems outside the conventional financial sector. It focuses on many practical issues, such as the identification of money/value transfer services, the procedures for licensing or registering such services and their customer due diligence procedures. This Best Practices Paper addresses the following topics:

- Definition of *money or value transfer service*
- Statement of Problem
- Principles
- Areas of Focus
 - (i) Licensing/Registration
 - a. Requirement to Register or License
 - b. Applications for Licence
 - c. Business Address
 - d. Accounts
 - (ii) Identification and Awareness Raising
 - a. Identification Strategies
 - b. Awareness Raising Campaigns
 - (iii) Anti-Money Laundering Regulations
 - a. Customer Identification
 - b. Record Keeping Requirement
 - c. Suspicious Transaction Reporting
 - (iv) Compliance Monitoring
 - (v) Sanctions

¹ The content of this paper is taken primarily from APG's Draft Alternative Remittance Regulation Implementation Package (Oct 2002.) This Best Practices Paper is intended to draw on the work of the APG Working Group on Underground Banking and Alternative Remittance Systems guided by Mark Butler and Rachele Boyle, into international best practices.

² See also the FATF Interpretative Note to Special Recommendation VI: Alternative Remittance.

Definition

3. Throughout this Best Practices Paper, the following definition from the Interpretative Note to SR VI is used.

4. *Money or value transfer service* (MVT service) refers to a financial service that accepts cash, cheques, other monetary instruments or other stores of value in one location and pays a corresponding sum in cash or other form to a beneficiary in another location by means of a communication, message, transfer or through a clearing network to which the MVT service belongs. Transactions performed by such services can involve one or more intermediaries and a third party final payment.

5. A MVT service may be provided by persons (natural or legal) formally through the regulated financial system or informally through entities that operate outside the regulated system. In some jurisdictions, informal systems are frequently referred to as *alternative remittance services* or *underground* (or *parallel*) *banking systems*. Often these systems have ties to particular geographic regions and are therefore described using a variety of specific terms. Some examples of these terms include *hawala*, *hundi*, *fei-chien*, and the *black market peso exchange*.

Statement of Problem

6. As 'Know Your Customer' and other anti-money laundering strategies come into operation in the formal financial sector, money laundering activity may be displaced to other sectors. Jurisdictions have reported increased money laundering activity using the non-bank sector and non-financial businesses. Measures should therefore be taken to obviate any increased abuse of the unregulated sector. MVT services are increasingly vulnerable to abuse by money launderers and the financiers of terrorism, particularly when their operations are conducted through informal systems involving non-bank financial institutions or other business entities not subject to the applicable obligations under the FATF Recommendations.

7. In addition to their use by legitimate clients, criminals have laundered the proceeds of various criminal activities using MVT services. Primarily, unregulated MVT services permit funds to be sent anonymously, allowing the money launderer or terrorist financier to freely send funds without having to identify himself or herself. In some cases, few or no records are kept. In other cases, records may be kept, but are inaccessible to authorities. The lack of adequate records makes it extremely difficult, if not impossible, to trace the funds after the transaction has been completed.

8. From recent research, it is suspected that the principal criminal activities engaged in by those who utilise MVT services are the illicit trafficking in narcotic drugs and psychotropic substances, illicit arms trafficking, corruption, evasion of government taxes and duties, trafficking in human beings and migrant smuggling. Recent reports indicate that international terrorist groups have used MVT services to transmit funds for the purpose of funding terrorist activities. (For example, investigation of the September 11, 2001 terrorist attacks has found that both the formal financial sector and informal MVT services were used to transfer money to the terrorists.)

Principles

9. The following principles guide the establishment of these best practices:

- In certain jurisdictions, informal MVT services provide a legitimate and efficient service. Their services are particularly relevant where access to the formal financial sector is difficult or prohibitively expensive. Informal MVT services are available outside the normal banking business hours. Furthermore, money can be sent to and from locations where the formal banking system does not operate.

- Informal MVT services are more entrenched in some regions than others for cultural and other reasons. Underground banking is a long-standing tradition in many countries and pre-dates the spread of Western banking systems in the 19th and 20th centuries. These services operate primarily to provide transfer facilities to neighbouring jurisdictions for expatriate workers repatriating funds. However, the staging posts of underground banking are no longer confined to those regions where they have their historical roots. Accordingly, informal MVT services are no longer used solely by persons from specific ethnic or cultural backgrounds.
- MVT services can take on a variety of forms which, in addition to the adoption of a risk-based approach to the problem, points to the need to take a functional, rather than a legalistic definition. Accordingly, the FATF has developed suggested practices that would best aid authorities to reduce the likelihood that MVT services will be misused or exploited by money launderers and the financiers of terrorism.
- Government oversight should be flexible, effective, and proportional to the risk of abuse. Mechanisms that minimise the compliance burden, without creating loopholes for money launderers and terrorist financiers and without being so burdensome that it in effect causes MVT services to go “underground” making them even harder to detect should be given due consideration.
- It is acknowledged that in some jurisdictions informal MVT services have been banned. Special Recommendation VI does not seek legitimisation of informal MVT services in those jurisdictions. The identification and awareness raising issues noted may however be of use for competent authorities involved in identifying informal MVT services and for sanctioning those who operate illegally.

Areas of Focus

10. Analysis of the investigations and law-enforcement activities of various jurisdictions indicate several ways in which informal MVT services have been abused by terrorists and launderers and suggests areas in which preventive measures should be considered.

(i) *Licensing/Registration*

11. A core element of Special Recommendation VI is that jurisdictions should require licensing or registration of persons (natural or legal) that provide informal MVT services. The FATF defines these terms in its interpretative note to Special Recommendation VI. A key element of both registration and licensing is the requirement that the relevant regulatory body is aware of the existence of the business. The key difference between the two is that licensing implies that the regulatory body has inspected and sanctioned the particular operator to conduct such a business whereas registration means that the operator has been entered into the regulator’s list of operators.

a. Requirement to Register or License

- At a minimum, jurisdictions should ensure that MVT services are required to register with a designated competent authority such as a Financial Intelligence Unit (FIU) or financial sector regulatory body. Registration of MVT services is likely to be a relatively cost effective approach when compared to the significant resources required for licensing.
- The obligation of licensing or registration applies to agents. At a minimum, the principal business must maintain a current list of agents which must be made available to the designated competent authority. An agent is any person who provides MVT service under the direction of or by contract with a legally registered or licensed MVT service (for example, licensees, franchisees, concessionaires).

b. Applications for Licence

- In determining whether an application for licensing can be accepted by the regulatory authority, it is clear that some form of scrutiny of the application and the operator needs to be conducted. This is in line with FATF Recommendation 23³ which states that regulators should introduce “*the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a financial institution.*”
- Authorities should conduct background checks on the operators, owners, directors and shareholders of MVT services. When considering the suitability of a potential operator, the authorities should conduct a criminal record check on the principal persons having control over the operations of the MVT service, as well as consult appropriate law enforcement databases, including suspicious or unusual reporting filings. Consideration should be given to defining the type of criminal record which would make the applicant ineligible to operate a licensed MVT service.

c. Business Address

- MVT services should be required to submit details of the addresses from which they operate and to notify the authorities upon any change of address or cessation of business. Where possible, this information may be made available to both the public so they may check which MVT service is properly licensed or registered before using their services, and to investigative / regulatory authorities during the course of their work. This also has value for financial institutions with which the MVT services maintain accounts as they are able to identify which MVT services are licensed / registered and thus are more able to identify illegal operators and to report to the FIU or appropriate competent authority accordingly.

d. Accounts

- In processing cash and in the settlement of transactions, MVT services use bank accounts. Some operators run a number of businesses, of which MVT service is one, and use business accounts to conduct or conceal the remittances of funds on behalf of their clients thereby masking the true origin of the commingled funds and accounts.
- MVT services should maintain the name and address of any depository institution with which the operator maintains a transaction account for the purpose of the MVT service business. These accounts must be capable of being identified and should be held in the name of the registered/licensed entity so that the accounts and the register or list of licensed entities can be easily cross-referenced.
- Traditional financial institutions should be encouraged to develop more detailed understanding as to how MVT services utilise bank accounts to conduct their operations, particularly when accounts are used in the settlement process.

³ When this Best Practices Paper was originally issued, these references were to the 1996 FATF Forty Recommendations. Subsequent to the publication of the revised FATF Forty Recommendations in June 2003, this text was updated accordingly. All references are now to the 2003 FATF Forty Recommendations.

(ii) *Identification and Awareness Raising*

12. Some informal MVT services are not known to regulatory and enforcement agencies, which makes them attractive to the financiers of terrorism. Identification of these MVT services will make it less attractive for criminal and terrorist groups to use them to facilitate and hide the financing of their activities.

13. For the majority of jurisdictions, proactive identification of informal MVT services is an integral element of establishing and maintaining an effective registration / licensing regime. Once informal MVT services have been located, compliance programs can be instituted under which the agents are approached, their details are recorded and they are provided information as to their obligations. Once regulatory regimes are in place, ongoing compliance work will include strategies to identify those MVT services not yet known to regulatory authorities. Jurisdictions may apply a range of strategies to uncover MVT services, using a number of approaches concurrently. Jurisdictions are encouraged to foster close co-ordination within the relevant authorities for the purposes of developing inter-agency strategies and using available resources to identify MVT services that may be operating illegally. Below is a list of suggested best practices for identifying MVT services and raising public awareness about their activities. As best practices, it is recognized that some of these suggestions may not be appropriate for every jurisdiction and that each jurisdiction must develop strategies best suited to its individual system.

a. *Identification Strategies*

14. Best practices in the area of identification strategies include:

- Examining the full range of media to detect advertising conducted by informal MVT services and informing operators of their registration/licensing obligations. This includes national, local and community newspapers, radio and the Internet; giving particular attention to the printed media in various communities; and monitoring activities in certain neighbourhoods or areas where informal MVT services may be operating.
- During investigations, information about informal MVT services may be uncovered which should be passed on to the competent authorities. Best practices include encouraging investigators to pay particular attention to ledgers of business that may be associated with informal MVT services; encouraging enforcement agencies to look for patterns of activity that might indicate involvement of informal MVT services; and, where possible, encouraging enforcement agencies to consider using undercover techniques or other specific investigative techniques to detect MVT services that may be operating illegally.
- Consulting with the operators of registered / licensed MVT services for potential leads on MVT services that are unregistered or unlicensed.
- Being aware that informal MVT services are often utilised where there is bulk currency moved internationally, particularly when couriers are involved. Paying particular attention to the origin and owners of any such currency. Couriers could provide insights for the identification and potential prosecution of illegal operators with whom the couriers are associated, especially when potential violations by couriers are linked back to the source of the informal MVT service operation.
- Paying particular attention to domestic suspicious transaction or unusual activity reporting, as well as to domestic and international large value cash reporting, to identify possible links to informal MVT services.

- Assisting banks and other financial institutions in developing an understanding of what activities/indicators are suggestive of informal MVT service operations and using this to identify them. Many informal MVT services maintain bank accounts and conduct transactions in the formal financial sector as part of other business operations. Giving banks the authority to cross-check particular accounts against a register of these operators and notify the relevant regulatory authority as appropriate.
- Once informal MVT services are identified international exchange of information and intelligence on these entities between the relevant bodies can be facilitated. Consideration could be given to sharing domestic registers with international counterparts. This strategy would also assist jurisdictions to identify local operators not previously known.

b. Awareness Raising Campaigns

15. Best practices in the area of awareness raising campaigns include:

- Making informal MVT services aware of their obligations to license or register, as well as any other obligations with which they may have to comply. Ensuring that the competent authorities responsible for overseeing and/or registering or licensing informal MVT services know how to detect those services that have not registered or been licensed. Finally, ensuring that law enforcement is aware of the compliance requirements for MVT services in addition to the methods by which those services are used for illicit purposes.
- Using education and compliance programs, including visits to businesses which may be operating informal MVT services to advise them of licensing or registration and reporting obligations, as opportunities to seek information about others in their industry. Using these outreach efforts by law enforcement and regulatory agencies to enhance their understanding about the operations, record-keeping functions and customer bases of informal MVT services. Extending outreach campaigns to businesses typically servicing informal MVT services (such as shipping services, courier services and trading companies). Placing in trade journals, newspapers or other publications of general distribution notices of the need for informal MVT services to register or license and file reports.
- Ensuring that the full range of training, awareness opportunities and other forms of education are provided to investigators with information about MVT services, their obligations under the regulatory regime and ways in which their services can be used by money launderers and terrorist financiers. This information can be provided through training courses, presentations at seminars and conferences, articles in policing journals and other publications.
- Issuing various financial sector publications of guidelines to encourage licensing or registration and reporting and also general material to ensure financial institutions currently subject to suspicious transaction reporting requirements develop an understanding of MVT services. (Also see section on suspicious transaction reporting on page 9.) Informing potential customers about the risks of utilising illegal MVT services and their role in financing of terrorism and money laundering.
- Requiring entities to display their registration/license to customers once they are registered/licensed. Legitimate clients will likely have a higher degree of confidence in using registered/licensed operators and may therefore seek out those operators displaying such documentation.
- Making a list of all licensed or registered persons that provide MVT services publicly available.

(iii) *Anti-Money Laundering Regulations*

16. The second element of Special Recommendation VI is that jurisdictions should ensure MVT services are subject to FATF Recommendations 4-16 and 21-25 and also to the Eight Special Recommendations.

17. There is key information that both regulatory and enforcement bodies need access to if they are to conduct effective investigations of money laundering and terrorist financing involving MVT services. Essentially, agencies need the information about the customers, the transactions themselves, any suspicious transactions, the MVT service's location and the accounts used. The MVT service must also have further records on hand available to regulatory and enforcement bodies as needed.

18. It is considered that to be effective in addressing the problem of MVT services, regulations should not be overly restrictive. Regulation must allow for those who abuse these systems to be found and stopped, but it should not be so burdensome that it in effect causes the systems to go "underground", making it even harder to uncover money laundering and terrorist financing through alternative remittance.

a. *Customer Identification*

19. The principle of Know Your Customer ('KYC') has been the backbone of anti-money laundering and counter terrorist financing measures which have been introduced to financial service providers in recent years, and this should also be the case for the MVT service sector. Customer identification requirements in the formal financial sector have had a deterrent effect, causing a shift in money laundering activities to other sectors. FATF Recommendations 4-10 and 12 concern customer identification and record keeping.

- FATF's Recommendation 5 is considered to be the minimum effective level which MVT services should be required to fulfil. The current recommendation sets out that the institution should be "*identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information*". The documents commonly acknowledged and accepted for identification purposes are identity card, passport, drivers' license or social security card. It is important for the credibility of the system that failure to produce an acceptable form of identification will mean that a client will be rejected, the transaction will not be conducted and, under specific circumstances a suspicious transaction report will be made.
- Proof of identity should be required when establishing a business relationship with the MVT service whether the relationship is a short term i.e. a single transaction, or a long term one. Transactions via phone, fax or Internet should only be conducted after customer identification complying with FATF Recommendation 5 has occurred (i.e., a business relationship has already been established). If the client's identification has not been previously established, then the transaction should not be processed.⁴

b. *Record Keeping Requirement*

20. Investigative agencies need to be able to retrace transactions and identify persons effecting the transactions (i.e. the audit trail) if they are to successfully investigate money laundering and terrorist financing. The requirement for MVT services to maintain records is essential for effective regulation of the field, but it is this area in which the balance between the regulator's needs and the burden on the operator most clearly needs to be struck.

⁴ See footnote 3.

- Jurisdictions should consider FATF’s Special Recommendation VII on Wire Transfers⁵ when developing guidance in this area. This recommendation specifically deals with funds transfers, including those made through MVT services. It should be noted that Special Recommendation VI covers the transmission of “value” as well as money.
- MVT services should comply with FATF Recommendation 10 to maintain, for at least five years, all necessary records on transactions both domestic and international. Jurisdictions should consider setting some minimum requirements for the form in which the records should be kept. Because records associated with MVT transfer services may often be coded and/or difficult to access, jurisdictions should also establish minimum standards for ensuring that they are intelligible and retrievable.

c. Suspicious Transaction Reporting

21. To maintain consistency with the obligations imposed on other financial institutions, jurisdictions should introduce transaction reporting in line with their current reporting requirements for financial institutions.

- Jurisdictions may consider issuing specific guidance as to what may constitute a suspicious transaction to the MVT service industry. Some currently used indicators of suspicious financial activity, such as those found in the FATF’s Guidance for Financial Institutions in Detecting Terrorist Financing, are likely to be relevant for money/value transfer service activity. However, particular activities and indicators that are unique to this sector should be further developed.
- The second half of FATF’s Special Recommendation VII on Wire Transfers should also be taken into account when developing guidance in this area. For example, operators that receive funds/value should ensure that the necessary originator information is included. The lack of complete originator information may be considered as a factor in assessing whether a transaction is suspicious and, as appropriate, whether it is thus required to be reported to the Financial Intelligence Unit or other competent authorities. If this information is not included, the operator should report suspicious activity to the local FIU or other competent authority if appropriate.

(iv) Compliance Monitoring

22. Regulatory authorities need to monitor the sector with a view to identifying illegal operators and use of these facilities by criminal and terrorist groups. Jurisdictions are encouraged to consider the following options:

- Competent authorities should also be entitled to check on unregistered entities that are suspected to be involved in MVT services. There should be an effective process for using this authority.
- Granting regulatory agencies or supervisory authorities the authority to check the operations of a MVT service and make unexpected visits to operators to allow for the checking of the register’s details and the inspection of records. Record keeping practices should be given particular attention.

⁵ Text of SRVII: Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain. Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information (name, address and account number).

- Establishing a process of identifying and classifying operators which are considered to be of high risk. In this context, "high risk" means those operators which are considered to be of high risk of being used to carry out money laundering or terrorist financing activities. Jurisdictions are encouraged to give such high risk entities extra attention from supervising authorities.

(v) *Sanctions*

23. In designing legislation to address this problem, one of the aspects to be considered concerns the sanctions which are available to redress non-compliance. If a MVT service operator is found to be non-compliant with the relevant requirements of the legislation the competent authorities would be expected to sanction the operator. Ideally, jurisdictions should set up a system to employ civil, criminal or administrative sanctions depending on the severity of the offence. For instance, in some cases a warning may initially suffice. However, if a MVT service continues to be in non-compliance, it should receive stronger measures. There should be particularly strong penalties for MVT services and their operators that knowingly act against the law, for example by not registering.

24. To monitor the continued suitability of an individual to conduct a MVT service, jurisdictions are encouraged to put systems into place which would bring any conviction of an operator, shareholder or director following licensing or registration, to the attention of the appropriate authorities. Consideration should be given to defining the type of criminal record which would make the applicant ineligible to be a MVT service provider.