

Regulation of Informal Value Transfer Systems

A Comparative Analysis of Five Remittance-sending Countries



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The Norwegian School of Management takes no responsibility for the methods used, results found and conclusions drawn.

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Acknowledgements

This work was inspired by the wish to know how a financial system based on trust, rather than contracts, could be integrated into the formal financial infrastructure in Western European countries. The potential development impact of remittances, the challenges related to economic crime and the importance of efficient remittance channels for the millions of migrants sending money back home, implies that this is a topic of great relevance and practical value. The regulation I have studied changed as I was writing, which made the work more difficult, as well as more interesting.

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List of Abbreviations

AML-CFT – Anti-Money Laundering - Combating the Financing of Terrorism

BAFIN - Bundesanstalt für Finanzdienstleistungsaufsicht (Germany: Federal Financial Supervisory Authority)

DfID – Department for International Development (UK)

DNB - De Nederlandsche Bank (Netherlands)

EEA – European Economic Area

EU – European Union

FATF – Financial Action Task Force

FDI – Foreign Direct Investment

FIU – Financial Intelligence Unit (Sweden)

FSA – Financial Services Authority (UK)

FTE – Full-Time Equivalent

GDP – Gross Domestic Product

HMRC – Her Majesty's Revenue and Customs (UK)

IMF – International Monetary Fund

IVTS – Informal Value Transfer Systems

ML-TF – Money Laundering and Terrorist Financing

MTO – Money Transfer Operator

NOK – Norwegian Krone

OECD – Organisation for Economic Co-operation and Development

ØKOKRIM - National Authority for Investigation and Prosecution of Economic and Environmental Crime (Norway)

PSD – Payment Services Directive (2007/64/EC)

SEK – Swedish Krona

SEPA – Single Euro Payments Area

STR - Suspicious Transaction Report

UK-MTA – UK Money Transmitters Association

UN – United Nations

1

INTRODUCTION

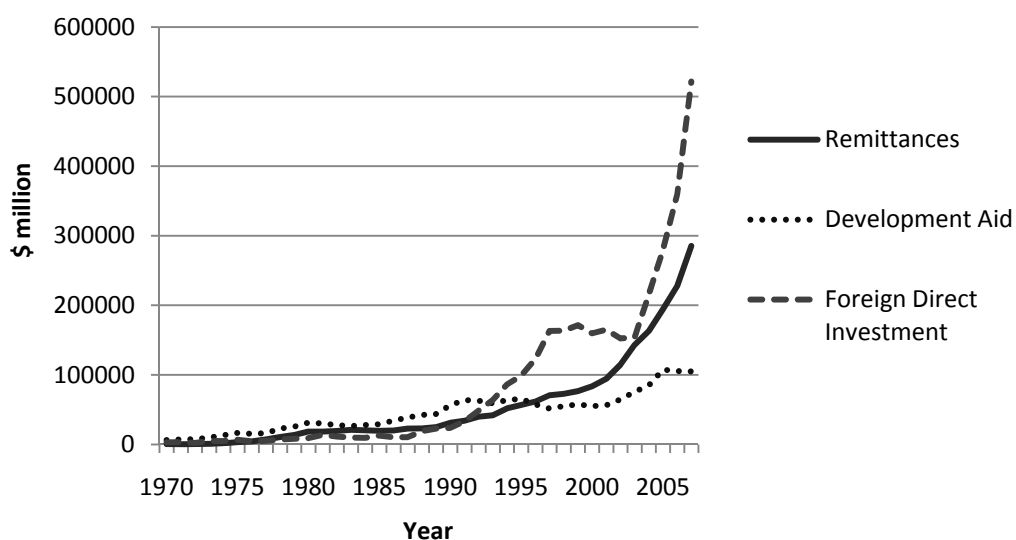
The attention for informal remittance systems increased sharply after the 9/11 attacks in 2001. The lack of records and government control of these systems have raised concerns about the vulnerability with regard to terrorist financing, money-laundering and other financial crimes. Still, these informal mechanisms seem to persist as they offer advantages in terms of speed, price, accessibility and familiarity. National authorities differ significantly in how they address money remittance providers, in terms of the requirements they impose, how these are enforced and sanctioned, and in the range of complementary policies. This study compares the regulatory approach of five remittance-sending countries, namely the UK, Germany, the Netherlands, Sweden and Norway. It assesses the level of control the national authorities have, as well as how efficient the market functions for the consumers. In doing that, the study tries to answer how the regulators can strike a balance between combating the abuse of informal systems and safeguarding the legitimate uses of such systems. In addition to answering the question on an empirical basis, recent theory on informal economies is consulted.

First, this chapter presents academic debate on the link between remittances and development. Second, a general introduction to the mechanisms of informal value transfer systems (IVTS) will be presented, highlighting its advantages as well as its potential for abuse. Finally, the aim, scope and relevance of this study will be explained.

Remittances and development

Remittances, and their implications for development, have received increasing attention in recent years. In 2007, an estimated \$336 billion of worker remittances were sent, primarily from developed to developing countries (IMF 2009). Remittances have become the second largest source of foreign capital in developing countries, after foreign direct investment (FDI). Figure 1 illustrates the increasing amount and relative importance of remittances over the past forty years.

Figure 1: Capital inflows to low- and middle-income countries.



Source: World Development Indicators 2009

A substantial part of the global remittance flows are sent from Europe. In addition to the \$52 billion sent within Europe, \$33 billion are sent to other destinations, primarily in Africa and Asia (Human Development Report 2009). The most significant European remittance corridors are: Spain – Colombia, Spain – Ecuador, Germany – Turkey, France – Portugal and France – Morocco (Eurostat 2007).

Remittances appear to be a more effective instrument in income redistribution than large, bureaucratic development programs, as the money goes directly to the people who need it (de Haas 2005). As remittances are less volatile and less pro-cyclical than other forms of capital inflows, such as FDI, hence constituting a more stable source of income (Gammeltoft 2002; Ratha 2003). It has also been pointed out that remittances can foster development through financial inclusion, in that people become connected to a financial system from which they would otherwise be excluded (Toxopeus and Lensink 2007). This paper, however, will not go into the extensive debate on the link between remittances and development, but rather assume that good transfer mechanisms is a positive feature in its own right. The transfer mechanisms can in themselves have development effects in the recipient country through financial inclusion, but this will not be debated in this paper.

Informal value transfer systems

Many migrants choose to rely upon informal value transfer systems (IVTS), when sending money to their relatives in their native country. A common feature for all IVTS is that they are based on trust and leave few traces for

those wanting to investigate the trail of values. IVTS comprise many different ways of transferring money. Some of these, according to Nikos Passas (2003:7), include Hawala, Hundi and Fei'Chien networks, courier services, physical transportation of cash, invoice manipulation schemes, black market peso exchange networks, gifts and money transfers via special vouchers.

For the purpose of this paper, the term Informal Value Transfer Systems will be used. It has been defined as “any system or network of people facilitating, on a full-time or part-time basis, the transfer of value domestically and internationally outside the conventional, regulated financial institutional systems” (Passas 1999:1). This term is used in order to include the whole range of regional and national variations in how these transfers are conducted. It also avoids misleading, but commonly used terms, such as underground banking (these systems are normally limited to money transfers, hence not acting as banks) or alternative remittance systems (in some regions, IVTS is the *only* option for sending money). One should note, however, that the term *informal* is partly misleading too. Informal enterprises are generally understood as informal due to their non-compliance with the regulations that apply to their trade, such as registration, operating licenses and taxes (Becker 2004). As will be illustrated later in this paper, some countries have taken steps to bring IVTS into the regulated sphere. As these businesses are then partly formalized and under *some* of the obligations that apply for mainstream financial institutions, they cannot by definition be classified as informal. One should also be aware that *informal* is not equal to *illegal*. For instance, hand-carried cash on behalf of relatives or friends is not illegal, but is nonetheless informal as it is not registered by the government (Carling et al. 2007:39). A more thorough discussion on the concept of the ‘informal economy’ will be given in the theoretical chapter.

Mechanisms of IVTS

Indeed, money transmission is generally seen as the most ethnically diverse sector within financial services. The Hawala system, having its historical roots in South Asia and the Middle East, is one of the most widespread IVTS. Hawala originated in the middle ages and was used for trade financing, due to the dangers related to travelling with gold and other forms of payment (El-Qorchi 2003). As Hawala and its regional variations constitute a large part of the IVTS, its main mechanisms will be explained here.

At the most basic level, a Hawala transaction happens in the following way. When a migrant worker in Country A wishes to send money to his relative in Country B, he contacts a local Hawala operator and gives him the amount he wants to transfer. In return, the sender receives a code, which he passes on to his relative via e-mail or telephone. The Hawala operator contacts a colleague

in Country B and requests him to disburse the agreed amount to the beneficiary. The relative in Country B can now receive the money (minus a small transaction fee to the operators) from the Hawala operator in Country B by showing the code. Now, the Hawala operator in Country A is indebted to the one in Country B, since the operator in Country A collected the money and the operator in Country B handed them out. Note that no physical transfer of money between the two operators occurred. This process is illustrated graphically in Figure 2. The Hawala operators will have their own cash pools to collect/make payments, and keep track of how much they owe each other at any point of time. The operator in Country B might be compensated by a Hawala transfer going in the opposite direction. The majority of flows, however, go *from* developed *to* developing countries. There are therefore numerous ways to settle the accounts, for instance by under/over-invoicing other goods or simply by a regular bank transfer (El-Quorchi et al. 2003).

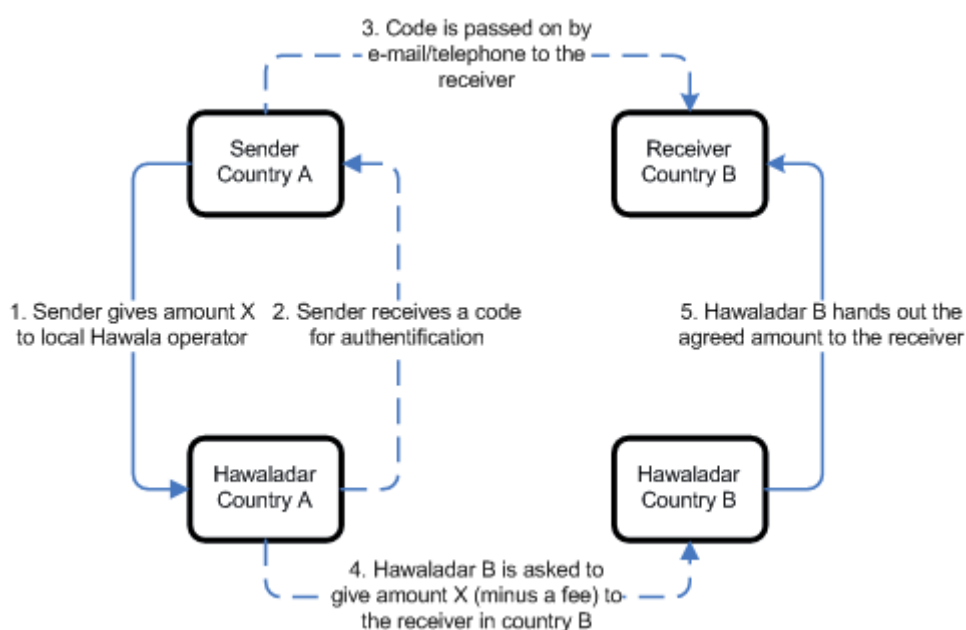


Figure 2: Basic mechanism of the Hawala remittance system

Source: Author's drawing, based on El-Qorchi et al. 2003

It should be noted that many Hawala businesses have evolved from this relatively basic setup to more advanced and large-scale business operations, having extensive distribution networks with hundreds of agents worldwide.

Advantages of IVTS

In a large number of situations, informal value transfer systems (IVTS), such as Hawala, offer advantages with which their regulated competitors cannot compete (Passas 2006; Nakhasi 2007; Ballard 2003). Many Hawala networks are run by a family or larger ethnic community. Hence, there is a high degree of trust between Hawala operators and customers, information and

communication through personal networks, and knowledge of social and cultural conditions.

Many studies emphasize the cost-effectiveness of IVTS (Rotschild 2006; El-Qorchi et al. 2003; Ballard 2003). Migrants generally remit relatively small amounts, and sometimes to very remote destinations. This combination can be fairly expensive via mainstream operators such as MoneyGram and Western Union, and attract commissions above 20% (see for example Carling et al. 2007), while a typical Hawala transactions costs 2-5% (El-Qorchi et al. 2003:7). A Hawala operator can have low overhead expenses by running his operation from a rented storefront, in combination with a phone agency or an import/export business (Jost and Sandhu 2000). The deals can be made over a coffee table and there is normally a low level of advertising. A commercial bank or a wire transfer operator will typically have to invest in proper facilities and alarm systems to evoke customer trust, hence increasing its overhead costs. A Hawala operation normally requires little paper work and there are few intermediaries involved. As there is trust both between the customer and the Hawala operators, and between the Hawala operators, one does not have to spend resources on setting up contracts, legal fees etc. The social capital embedded in Hawala networks, replaces physical capital, hence reducing the transaction costs, and the cost passed on to the consumer (Hernes 2007:138). Yet, it is clear that of the cost-effectiveness related to IVTS in some cases can be accounted to averting the regulatory burdens imposed on licensed remittance providers, or to taking advantage of illegal currency speculation.

Still, the Hawala system is surprisingly reliable. Many users of IVTS are undocumented migrants, who may not be able to make legal claims if they are defrauded. As the customers must rely on their interpersonal relation to the operator of the Hawala business, the operators will have clear incentive to invest in their reputation (Nakashi 2007). In line with other accounts on IVTS (Ballard 2005: El-Qorchi et al. 2003), Nikos Passas (2006:317) claims that “trust, mutuality of interest and self-regulatory arrangements, which characterize IVTS, have proved effective in protecting retail customers against losses”.

Moreover, the speed of carrying out transfers has by many been pointed out as the primary reason for why migrants resort to Hawala and similar systems. It is estimated that a typical Hawala transfer between two major cities takes 6-12 hours, and up to 24 hours in areas with poor infrastructure. Developments in ICT have greatly benefited informal systems, even though only a minimum of technology (such as telephone or e-mail) is required for the transfer to take place (El-Qorchi et al. 2003: 7). The limited requirements for infrastructure also contribute to the versatility of IVTS, making it a highly effective tool in countries that are subject to civil war, non-existent banking systems or

economic sanctions. One of the advantages of IVTS is their ability to adapt to sudden and dramatic societal changes, such as natural disasters and civil war (McCusker 2005:2; Nakashi 2007).

IVTS may be chosen by many migrants because it is tailored to their specific cultural or geographical needs. Language is a good example, but there are other factors to be considered as well. A large part of the remitters are Muslims, and Hawala can be seen as more compatible with religious concerns. Under Islamic Law there are procedures to deal with regulation of commerce and financing (Baldwin et al. 2002). For instance, the Quran encourages Muslim to build financial transaction based on “trust rather than contracts” (Hedstrom 2003, cited in Nakashi 2007).

Potential abuse of IVTS

IVTS, however, are often operating outside of the regulated economy. Concerns have thus been raised about the potential misuses of these systems. Policy makers have identified IVTS as weak links with regard to the combating of money laundering, terrorist financing and other financial crimes (Jost and Sandhu 2000).

Funds transferred informally are not subject to suspicious transaction reporting, where anomalies in money flows are detected by advanced search engines. Lack of documentation inevitably makes it more difficult for investigators to unravel larger criminal networks. Therefore, informal remittance networks can appeal to those wanting to engage in money-laundering, as this further complicates potential investigations. Since many IVTS have legitimate ties with trade-intensive business, such as import/export and travel agencies, it can serve as an effective tool to integrate proceeds of crime into the economy (Berti 2008:20). A study from the Netherlands showed that criminals using IVTS were not necessarily from the same ethnic community as the ones offering the service, showing that ethnic aspect of IVTS not always applies (van de Bunt 2008).

The lack of records and ID-requirements is arguably also appealing to those who finance terrorist activities. Allegedly, the al-Qaeda group responsible for the bombings of the American embassies in Nairobi and Dar es Salam (1998) had received funds through local Hawala operators (Ballard 2006). In addition, IVTS is said to facilitate tax evasion, black market currency exchange, illegal gambling and drug trafficking (Jost and Sandhu 2000).

Unrecorded foreign exchange transactions can distort the balance between national and foreign currencies, hence hampering investment flows (Berti 2008:20). Underreporting the inflow of remittances will in practice limit the receiving governments' opportunity for macro-level borrowing, as banks in

developing countries can securitize future flows of remittances (Siegel and Lücke 2010:102).

Research question

According to Maimbo and Passas (2004) informal remittance systems cannot be controlled only by means of criminal proceedings and prohibition orders. Policy makers must realize that informal systems, from the customer's point of view, serve a valuable function. In order to control IVTS, as well as for serving migrant workers legitimate demands, it is therefore imperative to take into account how the regulatory framework enables the provision of high quality remittance services. This should ideally be done in a way that does not compromise on the level of control. The following research question explores how the right balance could be found:

How can national authorities control informal value transfer systems without eliminating the advantages related to these systems?

In answering this question, I will first examine what five selected countries have done, and what they have achieved. Moreover, the developments in policy will be analyzed to explore whether a specific regulatory model is preferred among the countries. Theory on informal economies will be drawn upon to answer how informal economies should be understood, and on how they should be regulated by the government.

The term 'regulation' is used frequently when referring to governmental activity, yet there are many existing definitions, which vary significantly in scope. Baldwin and Cave (1999:2) categorize different usages of the term, from a specific set of commands to all forms of social control and influence. In this work, however, regulation will be defined as *deliberate state influence*. This encompasses a variety of state actions, not only legislation, designed to influence industrial or social behaviour. It includes economic incentives, deployment of resources and supply of information (ibid). Since the regulation of money transfer operators (MTO) can involve some degree of immigrant integration policy, it is relevant to also examine the policies that complement the relevant legislation.

Knowledge gap and relevance

It has been argued that the practices of supervising and regulating informal remittance systems have preceded a broad theoretical debate based on empirical knowledge. Many well-intended national approaches have therefore had adverse consequences, not only for the ones enforcing the regulations, but also for the flows of migrant money to developing countries (Maimbo 2003).

As mentioned earlier, informal remittance systems have many advantages and can deliver cheap, reliable, speedy and accessible services for migrant workers. Considering the enormous amount of remittances and their potential development impact, these flows should not be impeded. Small differences in the percentages charged on money transfers constitute major differences in the aggregate amounts flowing into developing countries. A good regulatory framework for remittances can therefore have a positive development impact in the recipient country. Heavy-handed actions against IVTS can have considerable humanitarian consequences, exemplified by the actions against the Somali *Al-Barakaat* network in the USA following the 9/11 attacks (Kapur 2004). This group of companies provided telecom and financial services in Somalia, where government and infrastructure were absent. When *al-Barakaat* and many of its managers were placed on the UN terrorist financing list, and their assets were frozen, many Somalis were consequently cut off from their main source of capital (Maimbo and Passas 2004).

At the same time, the presence of unrecorded flows presents significant challenges for national governments. There is evidence indicating that there are substantive informal remittance systems in most European countries, and that some of these have links to criminal organizations. Unrecorded flows prevent sound macro-economic policies and limits government's ability to borrow money (Berti 2008).

Yet, governments are uncertain as to how they should regulate IVTS, manifested in the significant variations within European countries. To my knowledge, no cross-country comparisons exploring both regulatory frameworks and their effects have been conducted. Indeed, it is called for a systematic and thorough effort to assess the impact of the regulation of IVTS (Passas 2005:12). This study seeks to fill this knowledge gap, by evaluating the available empirical data. It seeks a broader approach than for instance the FATF evaluations – which are preoccupied with Anti Money Laundering-Countering the Financing of Terrorism (AML-CFT) – by also considering how the markets fulfil the needs of the remitters.

2

METHODOLOGY

This section explains the methodology and research design of this paper. It explains which inferences it aims to draw, and the empirical basis on which this is done. It will carefully consider the various methodological challenges related to drawing causal inferences, including reliability, internal validity, construct validity and external validity.

Comparative case study

This study commends a qualitative approach, as there is a low number of quantifiable observations (small-N) and great uncertainties related to the existing statistics on remittances, not to mention on informal remittances. Statistical analysis has many advantages in terms of hypothesis testing, controlling for other variables, and ability to generalize to a larger population (Lijphart 1971). However, many situations require for practical reasons a smaller sample of cases. To encompass the nuances specific to each country, a more intensive study is required, and the number of countries included in the study is therefore limited to five.

Selection of cases

In order to make inferences about the nature and quality of a regulatory framework, a number of cases are necessary. These cases should reflect the different ways of regulating, as well as the different levels of effectiveness. The chosen country cases are the United Kingdom, Germany, the Netherlands, Norway and Sweden.

The chosen countries are all located in Northern Europe, are net-remittance sending countries, have substantial migrant communities, are members of the EU/EEA¹ and FATF, have a high level of economic development and are all liberal democracies. Table 1 provides some key statistics for the selected countries. All of the countries have a GDP per Capita clearly above the EU-

¹ Note that Norway, as a part of the EEA-agreement, is required to implement directives in the same manner as EU Member States.

average. They have international migrant stocks ranging from 8% (Norway) to 13% (Germany) of the total population. They all have considerable remittance outflows, even though great uncertainties are related to these figures, due to informal transactions and other measurement/reporting difficulties (Irving et al. 2010). It is important to note, however, that these countries are also different in many respects, for instance in size. Naturally, no countries are identical, but the relative similarity between these countries makes them suitable for comparison. Table 1 presents some key statistics for each country.

Table 1: Statistics for selected countries

| | Population in millions | Immigrant stock | | GDP | | Official remittance outflows** | | Estimated size of informal economy | |
|--------------------|---------------------------|-----------------|--------------------------|---------------|-------------------------|--------------------------------------|---------------------|---------------------------------------|---|
| | | Millions | Percent of population | Billion \$ | Per capita (PPP)* | Billion \$ | Percent of total | Percent of GDP | Rating among 21 OECD countries |
| UK | 61.6 | 5.8 | 9.4 | 2 645 | 116 | 5.05 | 0.19 | 12.1 | 5 |
| Germany | 82.0 | 10.5 | 12.9 | 3 652 | 115 | 14.98 | 0.41 | 16.8 | 12 |
| Netherlands | 16.4 | 1.7 | 10.5 | 860 | 134 | 8.43 | 0.98 | 12.6 | 7 |
| Sweden | 9.2 | 1.1 | 12.0 | 480 | 122 | 0.91 | 0.19 | 18.3 | 15 |
| Norway | 4.7 | 0.3 | 7.7 | 450 | 191 | 4.78 | 1.06 | 18.4 | 16 |

Sources: Eurostat 2010; World Development Indicators 2009; Schneider 2006

*Base: EU27=100

** This includes worker remittances, compensation of employees and migrant transfers. These numbers are generally not regarded as very precise. More about data collection on remittances can be found in De Luna-Martinez (2005) and Irving et al. (2010).

The IMF identifies two general categories of IVTS-regulation: registration and licensing (IMF 2005). The former impose very few requirements in order to have all IVTS-operators identified, whereas the latter impose more prudential requirements, such as a capital guarantee. Following IMF's classification, the UK and Sweden have registration regimes, whereas Germany, the Netherlands and Norway (until 2010) have licensing regimes (IMF 2005; KPMG 2003). Since the paper not only considers the relevant legislation, but also how it is enforced and complemented by other policies, it is useful to include more than one of each regime (registration/licensing).

Research design

In order to answer the research question, namely how the authorities can control IVTS without eliminating its advantages, a research design is necessary. This refers to the structure of the research – how the different pieces of evidence work together to answer the central questions. To make the research question more tangible, it is necessary to operationalize what the

study is trying to measure. In essence there are two different elements I wish to measure. Firstly the control authorities' exercise over IVTS and secondly how well the market functions in terms of providing quality services for remitters. In order to be able to measure the extent to which these concerns are present in the various national regulatory frameworks, an operationalization is essential. To be able to compare the regulatory effectiveness in the different countries in a fair and consistent manner, I have made six operational definitions, as shown in Figure 3. The first three operational definitions concern the level of control the authorities have of IVTS, while the last three refers to how the advantages of IVTS can be enjoyed by the consumers. These are explained in greater detail in Chapter 6 and 7.

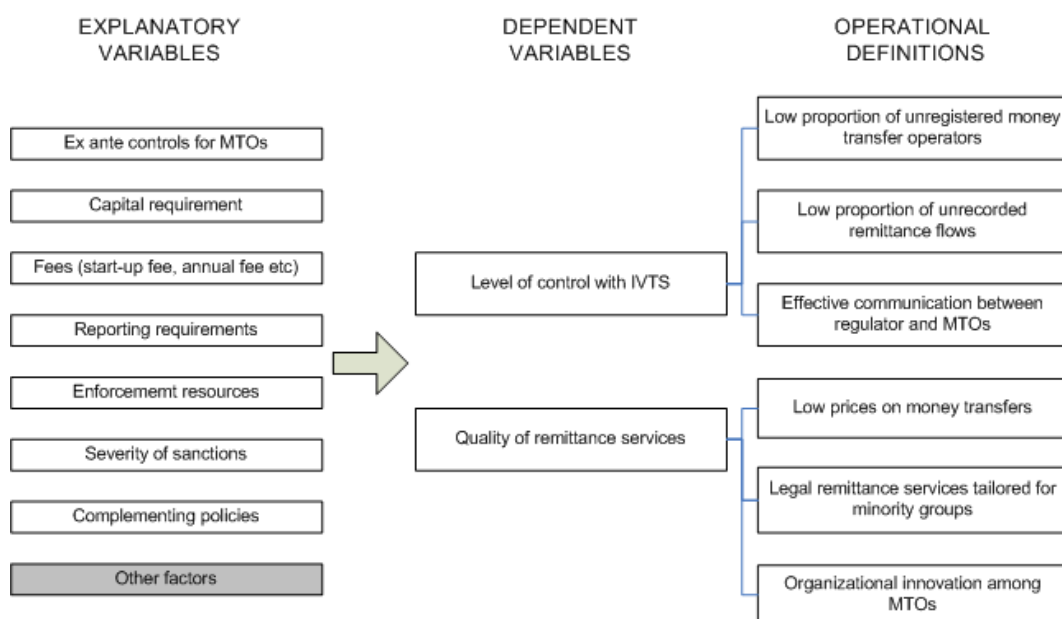


Figure 3: Research design

3

THEORY ON INFORMAL ECONOMIES

The dichotomy between the formal and informal economy has been present in the development discourse for more than half a century. The Dutch anthropologist Boeke (1942) was the first to describe a ‘dual’ economy, referring to the activities within the market economy and the activities outside of it. Lewis (1954) conceptualized this further, depicting a two-sector model of the economy with one sector comprised of profit-maximizing firms and the other sector of self-sustaining peasant households (Guha-Khasnobis et al. 2007:1). There is no single definition of informal economies that is universally accepted. Gërxhani (2004:271) lists definitions for informal economies in developed countries identified in the literature. Eleven different characteristics of the informal sector are mentioned, appearing in the various definitions. These are:

1. Lack of government regulation
2. Illegality
3. Non-appearance in the national accounts (GNP)
4. Absence of labour market requirements
5. Tax evasion and unreported income
6. Small scale of activities
7. Professional status as self-employed or family based
8. Lack of license/registration
9. Use of social networks
10. Autonomy and flexibility
11. Survival activities

These criteria will be applied to see if informal value transfer systems are varying with regard to informality in the different countries.

The traditional views on what constitutes informal economies have been widely criticized. In a UN Working Paper “new views” of the informal economy are presented (Chen 2007). Firstly, the informal economy is not fading away with modernization and industrial growth but continues to expand along with the formal economy. Secondly, the informal sector is not marginally productive, but is major provider of employment, goods and services. Thirdly, it is not separate from the formal economy, but rather highly intertwined. It would therefore be more sensible to consider economic activities along a continuum rather than as a dichotomy. Fourthly, the people

are not working informally primarily to evade taxes and escape government scrutiny, but would rather welcome efforts that would lower the barriers to entry in the formal economy (e.g. registration requirements). Finally, work in the informal economy is more than a subsistence activity, and most forms of informal activities are highly affected by economic policies (Chen 2007:5)². In Table 2, I suggest how the empiric on IVTS can be linked to old and new views of informal economies. This will be discussed on page 54.

Table 2: Empirical expectations to old and new views of the informal economy

| | <u>Old view of informal economies</u> | <u>New view of informal economies</u> |
|---|---|---|
| Use of IVTS | Decreasing along with economic growth | Steady/increased along with economic growth |
| Importance of IVTS services | Marginal | Highly important, delivered on a large scale |
| Integration with formal institutions | Two separate spheres of economic activity | Highly intertwined with formal economy |
| Motivation for operating informally | To avoid taxes and other regulatory burdens | Too high barriers to entry in the formal sector |
| Importance of economic policy | Low | High |

In the policy discourse the perceived equivalence between informal and unstructured has been “a powerful impetus for interventions that have often led to disaster” (Guha-Khasnobis et al. 2007:5). Formalization of informal activities needs to be based on a broad theoretical and empirical understanding of how the informal economies work, as the perception of informal economy will influence how the government should intervene. The link between the new view of the informal economy and its implications for the regulatory approach will be discussed on page 56.

² The paper also included two other factors (about employment in the informal sector) but these were excluded from my analysis as it was hard to apply them to IVTS.

4

INTERNATIONAL POLICIES

The international community in general paid little attention to IVTS before the 9/11 attacks in 2001. The attacks, however, increased the focus on how terrorism was financed and this led to more scrutinization of these networks (Passas 2006). This analysis will therefore focus on the regulation during the last decade. National policies have varied substantially in how they have addressed IVTS, and the approaches have also changed over time. This section outlines the international efforts on this matter.

Financial Action Task Force

The Financial Action Task Force (FATF) is an intergovernmental organization with 34 member countries, which was established in 1989 by the G-7 to counter international money laundering. After the 9/11 attacks FATF also assumed responsibility of combating terrorist financing. FATF has issued 40 recommendations on money-laundering and 9 special recommendations on terrorist financing, in which Special Recommendation VI (SR.VI) addresses informal remittances specifically. The recommendation calls for either registration or licensing of remittance institutions, and compliance with AML-CFT rules (FATF 2003):

“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.”

According to Borgers (2009:106), the FATF recommendations are so authoritative that they can be seen as the ‘gold standard’. All EU legislation on this matter has been consistent with and made explicit reference to the FATF recommendations. FATF conducts evaluations of the different member countries’ level of compliance, and specific advice is given on how the countries can improve their policies on each of the 40+9 recommendations.

The Third Money Laundering Directive

The Third Money Laundering Directive (2005/60/EC) was adopted in October 2005, and seeks to align the EEA members' policies with the recommendations of FATF. It extends for the first time the EEA anti-money laundering regime to also include combating terrorist financing (Katz 2007). It requires all member states to carry out fit-and-proper tests for owners and management of MTOs, to check if these are likely to use the business for criminal purposes. The directive also introduces more detailed requirements in terms of customer due diligence – meaning detailed guidance on when and how to control if customers are involved in illegal activities. Extensive control of the customer is required when establishing a customer relationship, and on transfers above €15 000. In addition, the directive provides that all transaction records should be stored for a minimum of five years (Directive 2005/60/EC).

EC Regulation 1781/2006

EC Regulation 1781/2006 introduced stricter requirements as to when money transmitters (and others) were required to verify the information presented by the customer (transactions above €1 000) and imposed obligations on the information having to accompany the funds (EC Regulation 1781/2006).

The Payment Services Directive

The EU Directive on Payment Services (2007/64/EC) provided a new legal framework for payments in the internal market and was one component used to facilitate the creation of a Single Euro Payments Area (SEPA). By establishing a comprehensive set of rules, the stated intention was to make cross-border payments as easy, efficient and secure as payments within Member States. Creating a *level playing field*³ in this area was deemed as important, in order to spur competition among payment service providers. A range of technical requirements were introduced for all payment service providers operating in the EU/EEA, such as banks, e-money providers, remittance offices etc. It introduced a maximum execution time of payments, meaning that all payments in Euro had to be carried out by the end of the next business day. The payment provider was also to be held liable in case of non-execution of payments. The user of the payment service was liable for a certain amount in case of misuse, such as losing his/her credit card. The full amount principle was introduced, meaning that the full amount specified in a payment

³ An environment in which all companies in a given market must follow the same rules and are given an equal ability to compete.

should be credited to the beneficiary, without any deduction (European Commission 2009).

The PSD's implementation date was in November 2009, although some countries delayed their implementation for some months. With regard to most provisions, it was a full harmonization directive, meaning that it had to be implemented equally in all EU/EEA countries.

In terms of remittance services, the Directive was relevant in a number of ways. It introduces the "Payment Institution" that is a payment service provider – apart from credit institutions, e-money institutions and certain public entities (post offices, central banks etc.) – that render post-paid payments and are *not* involved in credit taking or e-money transactions. In the PSD, Payment Institutions are subject to regulatory requirements which were more lenient than in the existing national regulations of many EU countries. The requirements of the PSD on Payment Institutions are based on the grounds that the activities they carry out have a significantly lower risk-profile than, for instance, the activities of banks, since they are not granting credit⁴ to customers or posing systemic risks (European Commission 2009). In many EU member states a banking license was required to offer remittance services and the PSD thus implied a reduction in entry barriers. Payment institutions authorized in one country could after the PSD use that one national single license to operate EU-wide.

The PSD introduced, in Article 26(1), a derogation clause in which Member States were allowed to waive certain 'microbusinesses' from many of the relatively burdensome licensing requirements (Mavromati 2008: 182). This required that the business in question had average money transactions of less than € 3 million per month⁵ and that the natural person(s) responsible for its operation was not convicted for offences related to money laundering or financial crimes. They would have to register their identity and comply with certain AML-CFT obligations, in respect of the provisions in the Third Money Laundering Directive (2005/60/EC). Waived businesses did not enjoy freedom of establishment or the freedom to provide services, meaning that they cannot use one national license to operate EU-wide.

In the preamble of the PSD, the waiver was justified by the general desirability of registering the whereabouts and identity of all remittance providers, and of according them some measure of acceptance, irrespective of their ability to

⁴ Payment Institutions are allowed to grant credit under PSD, but not with the funds received and held in relation to payment transactions.

⁵ Computed as an average of the 12 preceding months.

meet the full range of conditions (Directive 2007/64/EC preamble nr 15). In a memo about the PSD, the Commission claimed to waive the requirements for the following reasons (European Commission 2009):

1. To facilitate the market entry and innovation of new businesses without subjecting them to a too rigorous framework.
2. To ensure that small-scale remittance providers leave the black economy and become registered and identified by the authorities.
3. To comply with international obligations (i.e. FATF) to have all money remitters registered for AML-CFT purposes.

5

NATIONAL REGULATION OF MTOs

In their approach to informal value transfer systems, national regulatory regimes differ considerably. Under a registration regime, the main aim is to encourage remittance providers to keep basic records of their transactions and comply with AML-CFT requirements. This normally includes an application process, background checks, monitoring of compliance and AML-CFT preventive programs. Licensing regimes, on the other hand, are stricter in the sense that they oblige providers to demonstrate *ex ante* their ability to comply with regulations, for instance through fit-and-proper tests. Also capital guarantees, previous managerial experience, extensive reporting and business plans can be required (IMF 2005). It is hard to accurately determine the costs of having licensing requirements, but a report from the HM Treasury (UK) estimated that licensing would cost each business about £50 000 upon entry and £50 000 for every year of operation, due to legal fees, compliance manuals, training costs and a compliance officer (HM Treasury 2006:33).

This chapter outlines the main regulatory requirements for MTOs and how they are enforced in the countries included in the comparison. Complementing policies are also taken into account. Note that the regulatory frameworks described here are the ones in place before the Payment Services Directive was implemented in 2009/2010. Developments in policy will be mentioned in separate paragraphs and in the tables. A description to the tables is given in Table 3.

Table 3: Explanation to regulatory requirements

| General | |
|------------------------------------|---|
| Regulatory system | This describes whether the country has a registration or a licensing regime, as described in IMF (2005). |
| Use of waiver/threshold for waiver | Use of the waiver clause when implementing the PSD/ The maximum monthly turnover one could have on a simplified license under the waiver. |
| Number of registered MTOs | The number of separate entities operating as money transfer operators. Note that each MTO can have many premises or agents. |
| Authority | The institution with the main responsibility of supervising MTOs. |
| Sanctions | Available sanctions for operating without a license or not complying with the relevant legislation. |
| Use of non-financial agents | The ability to use non-financial agents (super markets, gas stations etc) to carry out payments. |
| Entry | |
| Capital requirement | Requirement of share capital or bank guarantee to get license as an MTO. |
| Fit and proper | Performance testing of the applicant's knowledge and experience of remittance systems, as well as examination of criminal background |
| Experience | Explicit requirement regarding the experience of the applicant |
| Criminal records | Requirement of not having been involved in various forms of financial mismanagement or crime. |
| Business plan /AML program | Requirement of a detailed business plan and AML-CFT programme upon application |
| Entry fee | Registration/licensing fee paid to the regulator upon entry. |
| Operation | |
| Verification of identity | Threshold for when the MTO is required to do further controls of the customer's identity. |
| Suspicious transaction reports | Requirement of reporting suspicious transactions to the relevant law enforcement agency. |
| Offsite information | Reports and forms of documentation required to be submitted on a regular basis. |
| Onsite visits | Ability and routine of regulator to conduct on-site visits. |
| Record keeping | Period in which transaction records are required to be stored. |
| Annual fee | Fee paid to the regulator on an annual basis to cover monitoring costs. |
| Annual audit | Requirement of annual auditing. |

The United Kingdom

The United Kingdom has a relatively long experience in addressing the challenges related to IVTS. Already in June 2000, the Cabinet Office and Performance and Innovation Unit issued a report where they proposed a balanced approach that would both “incentivize” and include all communities, while maintaining strict scrutiny and enforcement. Thus, the report recommended a “light touch approach” where the main aim was to avoid that overly burdensome and complex regulation would discourage MTOs from compliance. In essence, the approach aimed to maximize control in areas vulnerable to abuse, while still minimizing the administrative burden. The regulatory regime introduced in 2001 was based on this idea (Faulkner 2005). In 2007, there were 2150 registered MTOs in the United Kingdom (FATF 2007).

Regulatory requirements

The UK is classified as a registration regime (IMF 2005). This implies that it is relatively easy to establish a business, as no detailed business plan or capital guarantee is required. The independent money transmitters were regulated by HM Revenue and Customs (HMRC), and did sometimes have license to operate as *bureau de change* and cheque cashers as well. These three categories of activities constituted what was referred to as Money Service Businesses, which have been regulated by HMRC. HMRC sums up the requirements to the businesses in the phrase “CATCH”: Confirm the identity of the customer; Appoint a money-laundering officer; Train their staff; Control their businesses by having anti-money laundering systems in place; and Hold all records for at least five years (Faulkner 2005:45). The registration fee and the annual fee were both £60 (IMF 2005). The MTOs might operate jointly with non-financial businesses, such as travel agencies or call houses. The MTOs needed to be registered with the HMRC in order to get a regular bank account (FATF 2007:201). The full range of requirements is listed in Table 4.

Table 4: Requirements for Money Remittance Providers in the United Kingdom

| | Before PSD | After PSD |
|------------------------------------|---------------------------|------------------------------|
| General | | |
| Regulatory system | Registration | Registration |
| Use of waiver/threshold for waiver | | Yes/ €3 million per month |
| Number of registered MTOs | 2 150* | |
| Authority | HM Revenue and Customs | Financial Services Authority |
| Sanctions | Fines up to £5 000 | Fines, prosecution |
| Use of non-financial agents | Yes | Yes |
| Entry | | |
| Capital requirement | No | No |
| Fit and proper | Yes (from 2007) | Yes |
| Experience | No | No |
| Criminal records | Checked** | Checked |
| Business plan /AML program | No | No |
| Entry fee | £60 per premise | £500 per firm |
| Operation | | |
| Verification of identity | Transactions above €1 000 | Transactions above €1 000 |
| Suspicious transaction reports | Required | Required |
| Offsite information | Annual turnover | Annual turnover |
| Onsite visits | Risk-based | Risk-based |
| Record keeping | 5 years | 5 years |
| Annual fee | £60 per premise | £500 per firm |
| Annual audit | No | No |

Source: IMF 2005; FATF 2007; EC Regulation 1781/2006; European Commission 2010; personal correspondence with UK-MTA

*This number also includes those businesses that operate a *bureaux de change* and/or cheque casher in combination with money transmission.

** Before 2007, criminal records were checked, but had no consequences for the application.

Enforcement and sanctions

MTOs were subject to risk-based inspections. The top ten firms (controlling 71% of the premises) were automatically allocated a high level of supervisory resources, while the remainder, consisting mainly of small, independent MTOs, was assigned a risk level according to size, compliance history, relevant law enforcement, previous convictions of staff, and number/value of transactions. There were seven full time equivalent (FTE) officers assigned to assurance visits to all Money Service Businesses (3621 in total, of which 2150 are offering money transmission), assisted by 19.1 FTE intelligence officers who analyze the risk posed by each firm and 28.5 FTE assurance officers who actually undertook the compliance visits. HMRC can issue warning letters for firms not complying, and impose fines of up to £5000 per day (FATF 2007).

Complementary policies

HMRC has pursued a partnership approach with the aim of improving the businesses' ability to implement the AML-CFT regulations effectively. This includes industrial guidance and production of educational DVDs, among other things (FATF 2007:200). HMRC supported the establishment of a forum for MTOs that arranges seminars to discuss AML-CFT issues, in order to reach out to relevant ethnic communities. The UK Department for International Development (DfID) and HMRC also facilitated and supported financially the introduction and growth of UK Money Transmitters Association (UK-MTA), an industrial body that represents the interests of MTOs and work to improve the exchange of information between the businesses and the regulator. The financial support was crucial in order to make membership affordable for small-scale MTOs (Interview UK Money Transmitters Association, 18/6/2010).

The DfID has initiated Remittance Country Partnerships (RCPs) with Nigeria, Bangladesh and Ghana, all receiving large volumes of remittances from the UK. These partnerships included a variety of measures to remove barriers to remittance flows and improve access to financial services for rural and low-income groups. For instance, the DfID launched a web-page⁶ comparing price/speed on the different remittance services, available in relevant languages. The intention was, by improving transparency, to encourage competition and innovation in this sector and help remitters to make informed choices. DfID has also cooperated with the recipient countries to improve data collection on remittances (Hernández-Coss and Bun 2007:18-20).

⁶ www.sendmoneyhome.org

Policy developments

From having a relatively liberal approach in the early 2000s, the UK has gradually introduced more stringent requirements. Both the Directive on Money Laundering (2005/60/EC) and EC Regulation 1781/2006, led to more scrutinization of MTOs. In 2007, the HMRC introduced fit-and-proper tests upon entry, meaning that prospective MTOs would be rejected if they had been involved in some forms of economic crime, in line with obligation of the Money Laundering Directive. The UK introduced few major changes when implementing the PSD; except an upper threshold of €3 million per month for operating on a simplified license (waiver requirement). The MTOs had to re-register with the Financial Services Authority (instead of HMRC), either for full authorization (with license to operate EU-wide) or for the simplified registration under the waiver. A novelty of the new regulation is also that customer complaints about the waived MTOs can be sent to the Financial Ombudsman Service.

Germany

In Germany, MTOs are “financial service institutions” as defined by the Banking Act. They are licensed in the same manner as banks and other financial institutions, and have since 1998 been supervised by the Federal Financial Supervisory Agency (BaFin). The size of the German economy, coupled with the large number of foreign workers, has led to a high demand for remittance services, included those provided informally. In 2010, there were 39 licensed MTOs in Germany (FATF 2010).

Regulatory requirements

The IMF (2005) classifies Germany as a licensing regime, meaning that only remittance providers that can prove their ability to comply with the relevant regulation ex-ante are allowed to operate. To establish an MTO, the owners/managers must prove that they are trustworthy and have the required professional experience to manage such a business. If not in a commercial partnership with another licensed financial institution, it must have two managers with at least three years managerial experience working for the MTO (IMF 2005:39; FATF 2010:205). They must provide a business plan, adequate internal controls and routines for electronic data processing (KPMG 2003). In addition to comply with relevant AML-CFT regulation, they must provide audited financial statements every year, as well as regular reports in a prescribed format (KPMG 2003; FATF 2010). The fee of entry is €1000, and the annual fee is calculated on the basis of annual turnover (minimum €650) (IMF 2005). MTOs cannot use non-financial agents (grocery stores, gas stations etc.) to collect/make payments (De Luna-Martinez et al 2006:21)..

MTOs have conduct payments through licensed payment systems, which effectively exclude the more trust-based arrangements on which IVTS are built (SOURCE). The full range of requirements is given in Table 5.

Table 5: Requirements for Money Remittance Providers in Germany

| | Before PSD | After PSD |
|------------------------------------|---|---------------------------|
| General | | |
| Regulatory system | Licensing | Licensing |
| Use of waiver/threshold for waiver | | No |
| Number of licensed MTOs | 39 | |
| Authority | BaFin | BaFin |
| Sanctions | Warnings, order, withdrawal of license, fines, imprisonment | : |
| Use of non-financial agents | No | Yes |
| Entry | | |
| Capital requirement | No | Minimum €20 000 |
| Fit and proper | Yes | Yes |
| Experience | 3 years managerial experience | : |
| Criminal records | Checked | Checked |
| Business plan /AML program | Yes | Yes |
| Entry fee | € 1 000 | : |
| Operation | | |
| Verification of identity | Transactions above €1 000 | Transactions above €1 000 |
| Suspicious transaction reports | Yes | Yes |
| Offsite information | Quarterly | : |
| Onsite visits | On occasion, reliance on audit reports | : |
| Record keeping | 6 years | 6 years |
| Annual fee | % of annual turnover (min €650) | : |
| Annual audit | Yes | Yes |

Source: IMF 2005; FATF 2010; EU Regulation 1781/2006; European Commission 2010; Friedrich et al. 2007

“:” information not obtained

Enforcement and sanctions

BaFin routinely conducts visits to new licensees 4-6 months after the license has been issued, to verify that the control mechanisms have been put into practice. Thereafter, they rely on the annual AML-CFT audit. In BaFin’s money laundering program, there are six FTE employees assigned to the supervision of money remitters. They can enter premises, access books and records, seize evidence and take statements when investigating illegal activity. If the activity is indeed illicit, BaFin issues a ‘cease and desist’ order, where a warning is given. If the activity continues, the file is referred to the public prosecutor (FATF 2010). Offering unlicensed money transfers can give prison sentences up to three years (Friedrich et al. 2007)

Complementary policies

In order to improve the transparency in the German remittance market, the *Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)* and the Federal

Ministry for Economic Cooperation and Development (BMZ) launched a website⁷ with information about formal remittance services available in Germany, inspired by the British and Dutch equivalents (Holmes et al 2007).

Policy developments

As the German regime was relatively strict in to begin with, there have not been significant new obligations passed on to the MTOs by EU legislation. The Payment Services Directive nonetheless represented a liberalization of the payments market, even though Germany chose *not* to use the waiver option in the PSD. The most important change is that the directive allows that non-financial entities (supermarkets, phone agencies etc.) can be used as agents for money transfers.

The Netherlands

Money Transfer Operators in the Netherlands are governed by four laws, which are in place to protect the integrity of the financial system and to prevent ML/TF⁸. The Dutch central bank (DNB) is responsible for supervising the compliance of MTOs, and has specific mechanisms to cooperate with the public prosecutor and law enforcement to ensure that these objectives are met (Bökkerink 2005:35). There were 30 licensed money remitters in the Netherlands (IMF 2005).

Regulatory requirements

The Netherlands is classified as a licensing regime, with relatively stringent requirements for MTOs (IMF 2005). When establishing a business, the applicants must prove ex-ante that the operational management is capable of complying with the relevant legislation, and that the owners/management is beyond doubt trustworthy. They must also provide a bank guarantee, for customer protection purposes. The amount MTOs have received, but have not yet paid out, may never exceed the amount of the bank guarantee (Bökkerink 2005:38). Moreover, the MTOs must pay an entry fee of €3000, and an equivalent amount annually to cover the costs of supervision (IMF 2005). The MTOs have to deliver monthly financial reports, as well as annual accounts and an annual report (Bökkerink 2005:39). Also other businesses, such as

⁷ www.GeldtransFAIR.de

⁸ The Money Transaction Offices Act, the Identification of Services Act, the Disclosure of Unusual Transactions Act and the Sanctions Act

telephone businesses, can be licensed as MTOs (Unger and Siegel 2006:58). All requirements are listed in Table 6.

Table 6: Requirements for Money Remittance Providers in the Netherlands

| | Before PSD | After PSD |
|------------------------------------|---|---------------------------|
| General | | |
| Regulatory system | Licensing | Licensing |
| Use of waiver/threshold for waiver | | No |
| Number of licensed MTOs | 30 | |
| Authority | Central Bank | Central Bank |
| Sanctions | Warnings, order, withdrawal of license, fines | : |
| Use of non-financial agents | Yes | Yes |
| Entry | | |
| Capital requirement | Bank guarantee for outstanding amount | Minimum €20 000 |
| Fit and proper | Yes | Yes |
| Experience | No | : |
| Criminal records | Checked | Checked |
| Business plan /AML program | Yes | Yes |
| Entry fee | € 3 000 | : |
| Operation | | |
| Verification of identity | Transactions above €1 000 | Transactions above €1 000 |
| Suspicious transaction reports | Yes | Yes |
| Offsite information | Monthly | : |
| Onsite visits | 2-4 times per year | : |
| Record keeping | 5 years | 5 years |
| Annual fee | € 3 000 | : |
| Annual audit | Yes | Yes |

Source: IMF 2005; EC Regulation 1781/2006; European Commission 2010

“:” information not obtained

Enforcement and sanctions

The licensed remitters are visited two to four times a year, with an inspection team of six persons carrying out the inspections. The sanctions include warnings, ‘cease and desist’ orders and fines. In cases where there is suspicion of criminal activities, the case is always referred to the public prosecutor. One mechanism for cooperation is the Financial Expertise Centre, which is a coordinating body for exchange of information. By gathering information from all organizations that have a mandate in the financial sector, and analyzing this, criminal actions are revealed. The Dutch regulatory has been acknowledged as strict, with a ‘zero tolerance’ policy for offenders (Bökkerink 2005).

Complementary policies

IntEnt, a Dutch NGO promoting entrepreneurship among ethnic groups, has created a web-page⁹ to inform about the alternatives in the remittance market, with the support of the National Committee for International Cooperation and Sustainable Development, and the Dutch Ministry of Foreign Affairs. The Dutch Ministry of Finance has conducted studies on how to increase the use of formal channels from the Netherlands to Morocco and Suriname (Barendse et al. 2006a; Unger and Siegel 2006).

Policy Developments

Like Germany, the legislation in the Netherlands has been relatively strict from the outset, and EU directives have therefore not introduced more heavy-handed regulation. On the whole, no major changes seem to have been made with in terms of regulating money remitters, apart from the bank guarantee being replaced by the €20 000 capital requirement of the PSD.

Sweden

Sweden has, since 1996, applied a registration procedure for informal remittance providers, and its relatively liberal approach could in some sense be compared to that of the UK (KPMG 2003:12). The Swedish Financial Supervision Authority (Finansinspektionen) is responsible for the supervision of money remitters in Sweden (FATF 2006). There are about 75 registered money remitters in Sweden, of which the majority operates IVTS (Finansinspektionen 2008:58).

Regulatory requirements

Sweden is classified as a registration regime. Registration is only rejected if the owners or managers have a background of serious economic mismanagement or are convicted for economic crimes. The MTO can be either a juridical or a natural person. The former has to pay a registration fee of SEK 11 500 and an annual fee of SEK 10 000, while the latter pays on entry SEK 5 000 and SEK 3 000 annually (Kredittilsynet 2008:12). The registered entities have to comply with the existing AML-CFT laws (Lag (1996:1006: §4)), which require the remittance provider to take customer identification and report suspicious transactions to the Swedish Financial Intelligence Unit (Finanspolisen). They are also required to keep records for 5 years (Lag (2009:62: §13)). The full range of requirements is listed in Table 7.

⁹ www.geldnaarhuis.nl

Table 7: Requirements for Money Remittance Providers in Sweden

| | Before PSD | After PSD |
|------------------------------------|---------------------------------|---------------------------|
| General | | |
| Regulatory system | Registration | Registration |
| Use of waiver/threshold for waiver | | Yes/ €3 million per month |
| Number of registered MTOs | 75 | |
| Authority | Finansinspektionen | Finansinspektionen |
| Sanctions | Warnings, deregistration | Warnings, deregistration |
| Use of non-financial agents | Yes | Yes |
| Entry | | |
| Capital requirement | No | No |
| Fit and proper | Yes | Yes |
| Experience | No | No |
| Criminal records | Checked | Checked |
| Business plan /AML program | No | |
| Entry fee | SEK 11500/5000 (ca. €1200/520) | SEK 11500/5000 |
| Operation | | |
| Verification of identity | Transactions above €1 000 | Transactions above €1 000 |
| Suspicious transaction reports | Yes | : |
| Offsite information | : | : |
| Onsite visits | Yes, only on suspicion of ML/FT | : |
| Record keeping | 5 years | 5 years |
| Annual fee | SEK 10000/3000 (ca. €1040/310) | : |
| Annual audit | No | : |

Source: Kredittilsynet 2008; Lag (2009:62); Lag (1996:1006); EC Regulation 1781/2006; European Commission 2010

“:” information not obtained

Enforcement and sanctions

The Financial Supervision Authority was from 2008 allowed to conduct on-site visits, although this right was limited to the fields of money-laundering and terrorist financing (Kredittilsynet 2008). It should be noted that FI’s supervisory powers are limited. It has focused mainly on larger banks, and has not paid sufficient attention to MTOs, according to FATF (2006). The only available sanctions are rectification and de-registration (FATF 2006:115).

Complementary policies

In order to improve the level of knowledge and competences required for implementing sufficient AML-CFT procedures, Finansinspektionen has invited registered MTOs to participate on courses, held in Stockholm, Malmø and Gothenburg. Lack of interest among the MTOs, however, led to the cancellation of the courses in Malmø and Gothenburg (Kredittilsynet 2008).

The assets of the Somali al-Barakaat remittance network were confiscated following the 9/11 attacks, due to alleged links to Al-Qaeda. The Swedish government has been involved to have the Swedish branch of al-Barakaat removed from the list, as no links to terrorism could be proven, a diplomatic effort strongly opposed by the U.S. Department of State (Roth et al 2004: 84).

In 2009, the Swedish branch was taken of the list and the funds returned (Commission Regulation (EC) No 1033/2009).

Policy developments

Finansinspektionen was given powers to conduct on-sites visits to MTOs in 2008. It implemented the Money Laundering Directive in 2009 and the Payment Services Directive in 2010. The latter directive brought no major changes to the Swedish registration regime.

Norway

The regulatory framework in Norway has been characterized as rather strict, motivated by the government's strong intention to combat money laundering and terrorist financing (KPMG 2003). In Norway, only two companies (and their agents) have had a license to provide money remittance services, in addition to the banks. These are supervised by the Financial Supervisory Authority (Finanstilsynet).

Regulatory requirements

Norway applies a licensing regime for remittance providers. To operate remittance services in Norway one has to obtain a license as either a bank or a finance company. To obtain this license, one must firstly have a share capital of €5 million, although this amount can be lowered to €1 million in special cases¹⁰. Secondly, the remittance provider be regarded as 'fit and proper', meaning that the manager must have sufficient experience and a satisfactory criminal record. A detailed business plan must also be provided. The businesses must comply with the Money Laundering Act, which implies acquiring identification from the customers and reporting of suspicious transactions, and have a system for electronic supervision in place (Prop. 84L (2008-2009)). All requirements are listed in Table 8.

¹⁰ This has been done once, for Fexco Money Transfer Norway, in 2005.

Table 8: Requirements for Money Remittance Providers in Norway

| | Before PSD | After PSD |
|------------------------------------|---------------------------------|---------------------------------|
| General | | |
| Regulatory system | Licensing | Licensing |
| Use of waiver/threshold for waiver | | Yes/ NOK 5 million per month |
| Number of licensed MTOs | 2 | |
| Authority | Financial Supervisory Authority | Financial Supervisory Authority |
| Sanctions | Orders, fines, criminal charges | : |
| Use of non-financial agents | No | Yes |
| Entry | | |
| Capital requirement | €5 million (min €1million) | No |
| Fit and proper | Yes | Yes |
| Experience | Yes | Yes |
| Criminal records | Checked | Checked |
| Business plan /AML program | Yes | Yes |
| Entry fee | : | No |
| Operation | | |
| Verification of identity | Transactions above €1 000 | Transactions above €1 000 |
| Suspicious transaction reports | Yes | Yes |
| Off-site information | Automatic electronic reporting | Two times per year |
| Onsite visits | On occasion | : |
| Record keeping | 5 years | 5 years |
| Annual fee | : | Yes |
| Annual audit | Yes | Yes |

Sources: Kredittilsynet 2008; Prop. 84 L (2008-2009); European Commission 2010

“:” information not obtained

Enforcement and sanctions

The Financial Supervisory Authority is responsible for the supervision of money remittance providers, while the Norwegian National Authority for Prosecution of Economic and Environmental Crime (Økokrim) can in serious cases investigate unlicensed MTOs (FATF 2005). Investigating is an integral part of the general efforts against money-laundering and financial crimes carried out by Økokrim. Økokrim has in the time-frame 1999-2007 investigated nine cases related to IVTS, in which five cases resulted in a verdict (Carling et al 2007:9). The available sanctions include ‘cease and desist’ orders, fines and prison sentences.

Complementary policies

In 2007, the Peace Research Institute Oslo (PRIO) analyzed the remittance market in a report funded by the Norwegian Ministry of Foreign Affairs and the Norwegian Agency for Development Cooperation (Norad) (Carling et al. 2007). On the basis of the information from the survey, a web-site¹¹ with price/speed information was established. Also IVTS, operating illegally, were included in the comparisons. The web-site is static, however, meaning that it

¹¹ www.sendepenger.no

has not been updated since it was introduced in 2007. A new site is planned to be launched late 2010 (www.finansportalen.no).

Policy developments

Traditionally, only banks have been allowed to conduct foreign payments and currency exchange, prescribed in Currency Act of 1950. In 2004, the Financial Institutions Act extended this right to other financial institutions (e.g. foreign exchange companies). The PSD, implemented in 2010, introduced a simplified registration procedure for MTOs, targeted towards IVTS. It allowed MTOs to operate under the waiver, hence avoiding many of the licensing requirements. Most importantly, the MTOs were exempted from the capital requirement of €5 million (Finansdepartementet 2010).

Summary of requirements

As shown in the preceding sections, there are substantial differences between countries in how to regulate MTOs, in how the regulation is enforced and in how to complement the regulation with other policies. Table 9 gives an overview of the different approaches, in which the different factors are evaluated, relative to each other. It is a qualitative judgment of the level of measures based on the facts presented earlier in this chapter.

Table 9: Regulation overview for the selected countries (before PSD implementation)

| | Sweden | UK | Germany | Netherlands | Norway |
|-----------------------------------|---------------|-----------|----------------|--------------------|---------------|
| Ex-ante controls | Low | Low | High | Moderate | High |
| Capital requirement | None | None | None | Moderate | High |
| Fees (start-up and annual) | Moderate | Low | Moderate | High | N/A |
| Reporting requirements | Low | Low | High | High | Low |
| Enforcement resources | Low | High | High | High | N/A |
| Severity of sanctions | Low/none | Moderate | High | Moderate | High |
| Complementing policies | Low | High | Low | Low | Low |

At the most basic level, one can distinguish two kinds of approaches; a liberal approach, applying to the UK and Sweden, and a stringent approach in Germany, the Netherlands and Norway. This corresponds with IMF and FATF's classification of registration and licensing regimes. Both approaches are accepted under the FATF Best Practices Guidelines for Alternative Remittance Systems (FATF 2003). The changes over the last ten years, including the PSD, will be discussed on page 49.

6

LEVEL OF CONTROL

This chapter evaluates the level of control authorities have with IVTS. This is necessary in order to prevent illegal uses of IVTS, such as money laundering and terrorist financing, and to have satisfactory statistics on capital in- and outflows. The following elements will be used to assess whether the different regulatory regimes are successful from this perspective: Effective communication between the regulator and the businesses; Low proportion of unregistered MTOs; and Low proportion of unrecorded flows. Note that this section is evaluating the level of control under the regime in place *before* the PSD was implemented, as it would be premature to evaluate the effects of the new regime.

Communication between the regulator and the informal businesses

Effective regulation of a sector requires that there is continuous communication between the regulatory agency and the regulated businesses. This is important to ensure that the businesses become aware of new legislation and how to implement it, as well as enabling the regulator to assess how suitable and effective the legislation is. In many cases, the regulator is not even aware of the existence of all MTOs. In line with FATF Best Practices on IVTS, awareness raising campaigns and education/compliance programs is necessary to maintain an efficient regulatory regime (FATF 2003:5-6). This study will therefore include an assessment of the quality/extent of the communication.

United Kingdom

The UK has to a large extent institutionalized the communication with the small-scale independent MTOs. About 180 of the MTOs registered with HM Customs are members of UK-MTA, which works to represent the interests of these businesses (Interview UK-MTA, 18/6/2010). In addition to being the voice of the industry, they also provide training, information and support to MTOs to enable them to comply with the existing regulation. The UK-MTA arranges regular conferences on topics of common interest and engages in a continuous dialogue with the HM Revenue and Customs to ensure that the

relevant regulation is fairly and consistently applied. It also provides an online training course in AML-CFT practices, as well as general guidance material (www.ukmta.org).

Many of the registered MTOs report that they have money laundering programs in place to detect suspicious transactions. This includes Hawala-operators, which in many other countries run their business unregulated¹². The number of suspicious transaction reports from the HMRC-registered money transmitters was 8 377 in 2009, representing an increase since previous years. This number constituted 3.7% of the total number of suspicious transaction reports from financial institutions in the UK (HM Revenue and Customs 2010). A report by HM Treasury (2006b) revealed that there was a general lack of compliance among many of the registered businesses, as 45% percent had failed to implement one or more of the five basic requirements (CATCH). In addition, the level of suspicious transaction reporting from these businesses was deemed to be inadequate (HM Treasury 2006b).

Sweden

The extent of communication between Finansinspektionen and many of the MTOs can be characterized as rather limited. Some of the managers of MTOs have limited command of Swedish and English, and Finansinspektionen estimates that translation/interpretation costs needed for sufficient supervision would by far exceed the fees paid by the MTOs (Kredittilsynet 2008:13). There is little available information in foreign languages, and of the three AML-CFT-courses arranged by the FI, two have been cancelled due to lack of interest among MTOs.

The level of suspicious transaction reporting is not adequate, according to the Swedish Financial Intelligence Unit (FIU). In 2007, the MTOs reported 944 suspicious transactions (STRs) in total. These reports, however, came from only five MTOs, and one MTO accounted for 823 of the 944 STRs, meaning that most MTOs did not report anything at all (Finanspolisen 2007). It is primarily the small MTOs that do not report, due to lack of resources (Forsberg and Korsell 2006). This is alarming considering the general vulnerability of the money transfer sector, reflected by the high number of STRs submitted by some of the remittance providers.

¹² For instance the Somali-based Hawala-firms Dahabshiil (www.dahabshiil.co.uk) and Amal Express (www.amal-express.com).

Norway

The Norwegian MTOs have, like their counterparts in Germany and the Netherlands, operated underground. Yet, Hawala-operators in Norway have on several occasions contacted the Norwegian Financial Supervisory Authority with the intention of having their businesses licensed (Kredittilsynet 2008:6). A Somali interest group also expressed the views of Hawala-operators to the parliamentary Standing Committee on Finance and Economic Affairs when the implementation of the Payment Services Directive was discussed in 2010 (Norsk Somalisk Forum 2010; Stortinget 2010).

Proportion of unregistered money transfer operators

The ability of national authorities to supervise money transfers is influenced by the size of the black market for these services. Businesses operating underground will usually not keep records available for the police or report suspicious transactions. The number of unregistered providers, both in absolute and relative terms, is therefore a useful indicator for the level of control. Logically, there are no precise data on the size of the black market, so the evidence presented is estimations by researchers or regulatory agencies.

United Kingdom

The proportion of unregistered MTOs is expected to be relatively low in the UK, as the FATF evaluation (2007) did not point this out as a problem like it did in Norway, Sweden and Germany. The UK-MTA expects the number of unregistered MTOs to be rather small (Interview UK-MTA, 18/6/2010). As the threshold for registration is relatively low, and registration is needed to get a bank account, most remittance providers will logically chose to register.

Germany

In 2008, BaFin investigated 129 unlicensed MTOs. The number of investigated remittance providers has been between 100 and 200 annually, over the last five years. These have often been travel agents, import/export businesses or small retail outlets. BaFin characterizes the informal businesses as rather small in scale, even though one illegal operator that was shut down had an annual turnover of €6-7 million (FATF 2010:205). The high number of investigations indicates that there are a considerable number of unlicensed businesses operating. Professor in Economics and expert on informal economies, Friedrich Schneider, estimates that there are up to 2 000 unlicensed MTOs in Germany (Stahnke 2009). A case study on the Germany-Serbia remittance corridor revealed that many bus drivers covering the route

between the two countries, personally offered remittance services beside their driver occupation (De Luna-Martinez et al. 2006).

The Netherlands

Surveys of the remittance market in the Netherlands (Mohogu 2006; Consumentenbond 2005) revealed that there was a wide range of informal providers offering money transfers. The informal transfer mechanisms included hand carried cash by friends and other trusted persons, credit schemes run by traders, IVTS through mosques and small shops (travel agencies etc.) offering money transmission.

Sweden

In 2003, the number of unregistered providers was estimated to 20-30, and Swedish authorities expressed that this problem persisted five years later (FATF 2006: Kredittilsynet 2008). The FATF evaluation of Sweden pointed out that people who collect payments and send them through the bank system, which is often the case for IVTS, would not necessarily fall under the scope of the AML-CFT Acts if 'negotiating payments' was not the main component of the business. Therefore, it was unclear whether restaurant owners (and others) who carried out additional remittance services actually fell under the scope of regulation (FATF 2006).

Norway

Økokrim has investigated nine cases of IVTS in Norway in the time-span 1999-2007, involving two networks of Somali and seven networks of Iraqi Kurd origin (Økokrim 2007). Dahabshiil International, a large Somali remittance network, informed the Norwegian Financial Supervisory Authority that they operated in many Norwegian cities, and had three premises only in Oslo (Kredittilsynet 2008:8). Another source estimated 30 Hawala businesses of Somali origin in Norway (Interview Somalisk ressurs- og rehabiliteringssenter 15/7/2010). Økokrim (2007) also expected, based on suspicious transaction reports from banks, that there were also networks transferring money to Afghanistan, Iran and Sri Lanka. This indicates that there are more networks existing than those that were investigated and that IVTS are widely used.

Proportion of unrecorded remittance flows

Flows of money leaving (or entering) the country unrecorded will tend to reflect a lack of control. Money sent through Hawala-businesses or other informal schemes, or carried physically from one country to another, are not

recorded in official statistics or subjected to different forms of control. One should, however, be aware that Central Banks have difficulties in compiling statistics for remittances sent through regulated channels (Irving et al. 2010). The estimations of informal flows presented below will primarily be based on findings from different household surveys, and estimations by regulatory agencies.

United Kingdom

According to one survey (Hassen and Chalmes 2008) Somali remittance companies cover 92% of the transfers from the UK to Somalia. Most of the larger companies serving the UK – Somalia corridor, such as Dahabshiil, Quaran Express, Mustaqbal and Amal Express are all registered with the HM Customs and members of the UK-MTA.¹³ This shows that most of the money going from the UK to Somalia is recorded.

On the other hand, a World Bank survey on the UK - Nigeria remittance corridor estimated that about 50% of the remittances were sent informally, normally by hand-carried cash (Hernandez-Coss and Bun 2007:13). This illustrates that there are great differences between the corridors. A report to DfID in 2004 (Blackwell and Seddon) estimated that £1.4 billion were remitted from the UK annually, of which £0.5 billion went through informal channels. As this report came before the HMRC's registration regime was fully implemented, one can expect that this number is significantly lower now.

Germany

The amount of informal and unrecorded remittance flows from Germany can be expected to be rather high, reflected in the high number of informal providers. For instance, in a survey of the Germany – Serbia remittance corridor, it was estimated that about 50% of the total transfers (\$476 million) went through informal channels, mainly cash carried personally or sent through bus drivers (De Luna-Martinez et al. 2006:10). A study on the Germany - Albania corridor confirmed this pattern, as about two-thirds of the Albanians residing in Germany preferred to bring cash themselves, rather than sending it through a bank (Holmes et al. 2007:17). Similarly, a small survey of 139 respondents (from Albania, Ghana, Morocco, Serbia and Vietnam) revealed that 66 (47%) of these chose to transfer their money informally (ibid: 18). Another survey suggests that while the proportion sending money informally to Turkey is relatively low, are more than 50% of the remittances to Lebanon, Syria and Jordan sent informally, mostly as hand-

¹³ See UK-MTA member list at www.ukmta.org/directory.aspx

carried cash (Barendse et al 2006b). The FATF-evaluation concludes that there seems to be a high demand in Germany for remittance services outside the regular banking sector (FATF 2010:206)

The Netherlands

There has been conducted relatively many corridor studies in the Netherlands, which all seem to indicate substantive informal remittance flows. A comprehensive study on the Netherlands – Moldova corridor suggests that 52% the flows are transferred informally, mainly through hand-carried cash (Siegel 2010:109). In a larger consumer survey (Consumentenbond 2005) with 1336 respondents from six different ethnicities it was revealed 52% the Turks in the Netherlands, 62% of the Moroccans, 50% of the Surinamese, 47% of the Dutch Antilleans, 73% of the Somalis and 43% of the Ghanaians had an *informal* channel as their main remittance mechanism. Another survey found that 73% of Somalis, 53% of Ghanaians and 36% of Nigerians use informal channels to transfer money (Mohogu 2006:47). Of the informal mechanisms, physical transport of cash and Hawala-like enterprises were the most frequently used (ibid:25). Another survey (Barendse et al. 2006a) comes up with a relatively different figure for the Morocco corridor, stating that only 24-28% is transferred informally. This illustrates the uncertainties related to these numbers.

Sweden

According to the Swedish Financial Intelligence Unit (Finanspolisen), €107 million was remitted informally in 2004, which was about the same amount that was sent through formal channels (FATF 2006:114). Another study estimates that around 30% is remitted informally, but this number is based on a very small sample of respondents (Engdahl 2007). This level (30-50% of total remittances) is comparable to that of Germany and the Netherlands.

Norway

Økokrim investigated nine cases of Hawala, and it was estimated that these transferred NOK 600 million (ca. €75 million) in the time-span 1999-2007 (Økokrim 2007:8). The previous section showed evidence that there were probably far more unlicensed MTOs than those that were investigated, meaning that this figure is probably higher.

QUALITY OF REMITTANCE SERVICES

According to much of the literature on IVTS (see introduction), these systems can deliver remittance services of high quality. Hence, in order to fully take advantage of IVTS, the regulatory framework should formalize IVTS without eliminating these systems' comparative advantages. This section investigates how the different markets satisfy the needs of the remitters.

Prices on money transfers

The regulatory framework for money transfer operators will influence the prices on the services they provide. Firstly, because the various requirements imply certain costs, which in turn must be paid by the consumers. Secondly, the threshold for establishing a business (capital requirements, level of legal expertise etc) will effectively determine the number of firms entering this market. If the remittance market is dominated by very few firms, the competition is arguably inadequate to push the prices down. In line with standard microeconomic theory, more firms in the market will lead to lower prices. In evaluating the quality of regulation, price is logically an important factor. Naturally, the conditions in the recipient countries are of equal importance to the price, but a discussion on the regulation in these countries fall outside the scope of this study.

The cost of a remittance service can include many components, such as fees on sending side, fees on receiving side, currency conversion costs and indirect/opportunity costs (Carling et al. 2007). To come up with a valid comparison is therefore challenging. This analysis will firstly be based on information from the World Bank web-site, which provides the only streamlined source of data on remittance prices (World Bank 2009b). It measures always the local currency equivalent of sending \$200 and \$500, which are typical remittance amounts. The prices are corridor-specific and cover costs in sending and receiving country, as well as the exchange rate spread. Of the countries investigated in this study, the UK, Germany and the Netherlands are included in the database. They are compared on average total

cost in percent from third quarter 2009¹⁴, on the all the corridors where there is data on more than one sending country.

Figure 4 and Figure 5 show the prices of sending \$200 and \$500, respectively. For sending \$200, the UK appears to offer the lowest prices. In comparison to Germany, the UK is slightly more expensive in transfers to China, but significantly cheaper when sending to India and Romania. Compared to the Netherlands, the UK offers somewhat cheaper services to Ghana and Nigeria. Comparing Germany and the Netherlands, Germany is cheapest to Turkey and the Netherlands cheapest to Morocco. The general pattern remains the same for \$500, except that the UK providers seem to charge higher prices for this amount. The average percentages charged, for the selected corridors¹⁵, as well as for all available corridors from the three countries are presented in Table 10. Estimations for quarter 1 of 2010 by the World Bank confirm that remittance prices in the UK are somewhat lower than in the Netherlands, and substantially lower than those in Germany (World Bank 2010b:2).

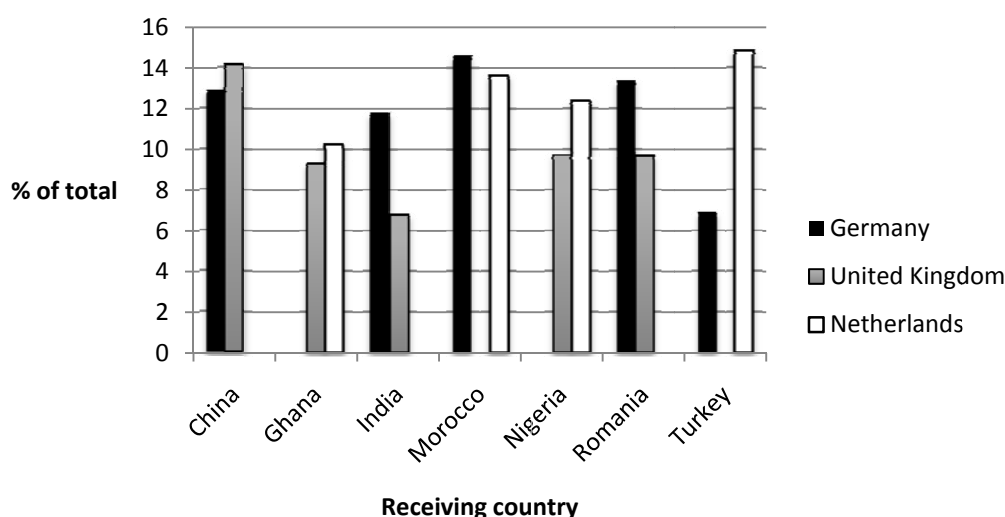


Figure 4: Remittance prices in percent of \$200 in selected corridors

Source: World Bank Remittance Prices Database

¹⁴ Even though there are available prices from 2010, the 2009 prices will be used here in order to assess the effects of the regulatory framework *before* the implementation of the EU Payment Services Directive.

¹⁵ That is from the UK and Germany to China, India and Romania; from the UK and the Netherlands to Ghana and Nigeria; and from Germany and the Netherlands to Morocco and Turkey.

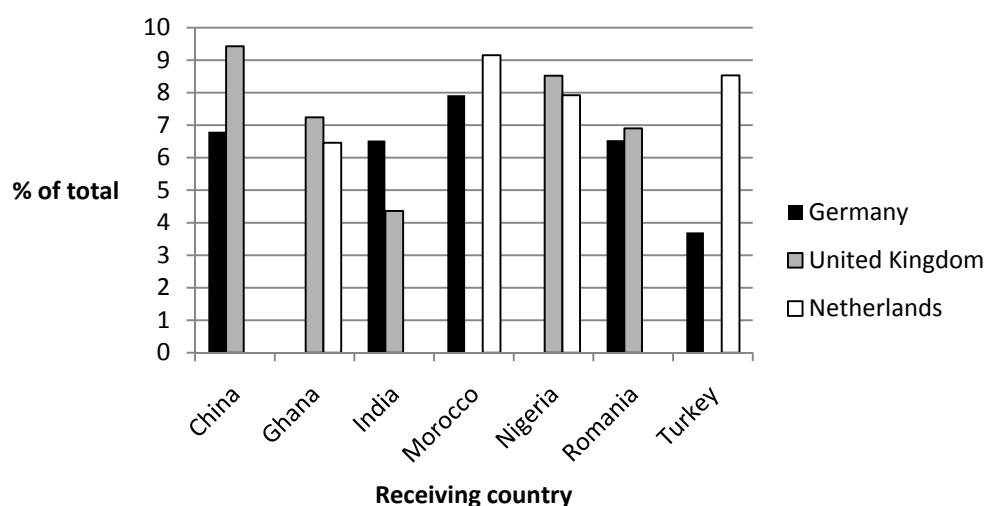


Figure 5: Remittance prices in percent of \$500 in selected corridors

Source: World Bank Remittance Prices Database

Table 10: Average prices on selected and all corridors, for \$200 and 500

| | Selected corridors ¹⁵ | | All available corridors ¹⁶ | |
|-----------------------|----------------------------------|-------|---------------------------------------|-------|
| | \$200 | \$500 | \$200 | \$500 |
| Germany | 11,9% | 6,3% | 12,8% | 6,4% |
| United Kingdom | 9,9% | 7,3% | 9,5% | 6,8% |
| Netherlands | 12,8% | 8,0% | 11,7% | 7,5% |

Source: World Bank Remittance Prices Database

When gathering these data, the World Bank team requested price information from the main MTOs and banks, normally the eight or ten biggest. Thus, many of the small-scale MTO, which tend to offer lower prices than the average, are excluded from the statistics (World Bank 2009). Since the UK has a large number of small-scale MTOs (see Table 4), this estimation error will probably present the UK prices as higher than they actually are.

Comparable data for Sweden and Norway is unfortunately not available. However, a Norwegian market survey¹⁷ from 2007 illustrated that the costs of remitting NOK 1000 (ca. \$160) ranged from 13.5% to 23.4% when using one of Norway's two MTOs (Western Union and MoneyGram). For NOK 5000 (ca. \$800) the prices ranged from 10.5% to 18.4% (Carling et al. 2007:46-48). These prices are relatively high.

¹⁶ 8 corridors from the Netherlands, 10 from Germany and 25 from the UK

¹⁷ Measuring remittance prices to Bosnia, Chile, Iraq, Kenya, Lithuania, Morocco, Nigeria, Pakistan, Philippines, Poland, Somalia and Vietnam

Legal remittance services tailored for minority groups

The availability of services tailored for specific cultural and geographic needs will also serve as an indicator of the quality of remittance market. Other parameters, such as speed and reliability, are hard to compare. The speed of transfer can often be cheaper if the user is willing to pay a higher amount.

Accessibility

The number of MTO agents in the sending country differs significantly. In the UK there are 2 150 companies (in addition to banks) offering money transmission, with 25 950 premises all over the country (FATF 2007:18). In comparison, the Netherlands has about 6 000 premises for money transmission, of which the majority are post offices acting as agents for Western Union (Barendse et al. 2006a:43). Norway had in 2007 as few as 19 money transfer offices, and it was revealed that more than half of Norway's non-western population (127 600 people) were not living in proximity to an MTO agent (Carling et al. 2007:34).

Accessibility on the receiving side is often of greater importance. For instance Somalia has no banks, and the bigger MTOs (Western Union, MoneyGram) are not delivering funds to that destination. There are registered Somali money transfer businesses operating in Sweden and the United Kingdom¹⁸. In the Netherlands, one Somali company (Kaah Express) has acquired a license (since 2001) and is acting as an agent for MoneyGram (De Nederlandsche Bank 2010), hence enabling transfers to Somalia. In Germany and Norway, there are no legal services covering this remittance corridor.

Other remittance-receiving countries might have limited financial infrastructure, with companies based mostly in larger cities. Much of the literature on IVTS suggests that informal services are essential for people living in more remote areas, as they can operate in areas that are not commercially viable for larger companies. The versatility and mobility of IVTS comes from the fact that their functionality in its most basic form is only dependent upon the ability of two people to communicate with one another (Nakashi 2007:13).

Familiarity

In a study of the Norwegian remittance market, it was found that one reason why migrants chose to remit informally was the lack of familiarity with the

¹⁸ Register of authorized payment institutions in Sweden (www.fi.se) and the UK (www.hmrc.gov.uk/mlr/msbregister)

formal remittance providers. It was discovered that banks had a general lack of knowledge about the migrants' country of origin and the habit of remitting as well as insufficient information in foreign languages. On the other hand, Western Union had recruited people from minority groups and was able to offer information in many languages (Carling et al 2007:56). Similarly, in a Dutch survey (Lucas 2010) the migrants interviewed responded that they had problems communicating with the banks because all the information was in Dutch.

An important point relating to the social side of IVTS is given in Monsutti (2004). Most literature considers the choice between formal and informal mechanisms as an economic one. Exchanges, however, do not only satisfy economic needs, but also serve as a way to reproduce social ties. The circulation of documents, people and money bring together religious, judicial, political, economic and family elements, in times where communities are dispersed across countries. Sending remittances can be seen as an element in a complex relationship between migrant workers and their home communities (Carling 2008). The value-added related to these social aspects is important to bear in mind when regulating money transfers. To have small MTOs, whom the sender might know personally, dedicated to a specific remittance corridor will thus often be seen as an advantage for many remitters. In the UK many MTOs are advertising towards specific ethnic communities, often in their native languages (Blackwell and Seddon 2004:10). Logically, the vast number of MTOs in the UK reflects that there are more providers targeting more specific cultural and geographical demands. In Germany, there are MTOs providing corridor-specific services to the Phillipines, Turkey, Iran, Ghana, Morocco and Vietnam (Friedrich et al. 2007).

Organizational innovation among MTOs

The remittance companies will, as most other companies, adapt to the regulatory environment. The extent to which IVTS are legal and regulated could arguably influence how the MTOs choose to organize their business operations. That could include the range of customers targeted, interaction with the rest of the financial sector (e.g. banks) or the scale of the business operations/networks. If it turns out that IVTS businesses become less ethnically closed, more integrated with the regular financial sector and develop more professional business models under certain regulatory conditions, this would serve as an indication of successful regulation.

The quality of and accessibility to information about the services (for instance on price, transfer speed and availability) is essential for the customers to make informed choices about which service to choose. In countries where IVTS

have operated illegally, such as Norway, they have been characterized as 'ethnically closed' (Økokrim 2007). The IVTS operating as registered companies in the UK, on the other hand, are more open about their businesses and often have web-pages with prices and agent locations.

The Somali MTOs in the UK can serve as a case in point. According to Lindley (2010), these businesses have in countries where the regulatory requirements have permitted it, become increasingly professional. Services such as online tracking, express delivery and text alerts have been offered and the customer base have expanded beyond the intra-clan relationships (ibid). These businesses have taken part in AML-CFT training programs offered by the UK-MTA. While much of the traditional literature on IVTS suggests that the settlement of accounts between Hawala operators often is done in illegitimate ways (for instance by over- and under invoicing), this is also often settled through regular bank transfers. In the UK most small MTOs are fully dependent on having a bank account to carry out their business (UK Money Transmitters Association 2010). Traditional Hawalas are also claimed to solve their disputes through self-regulation. In the UK, however, customers using a registered Hawala have under the new regulations the right to complain to the Financial Ombudsman Service, indicating that the sector is becoming increasingly formalized.

In the Netherlands there have been some forms of cooperation between formal and informal providers. For instance has the Somali company Dahabshiil (not licensed the Netherlands) had an agreement with MoneyGram to use the Dahabshiil network to carry out payments in Somali, Ethiopia and Djibouti (Mohogu 2006). This illustrates that the border between formal and informal sometimes is unclear.

8

DISCUSSION

How and why have national policies developed?

One decade ago, when more attention became directed towards regulation of IVTS, the regulatory frameworks differed considerably. Sweden and the UK had light-touch procedures with few ex-ante requirements, small fees and basic AML-CFT regulation. In other countries, such as Norway, market entry was confined to larger financial institutions that could meet the wide range of criteria. Now, however, it is evident that the policies have become more similar, even though there are still considerable differences.

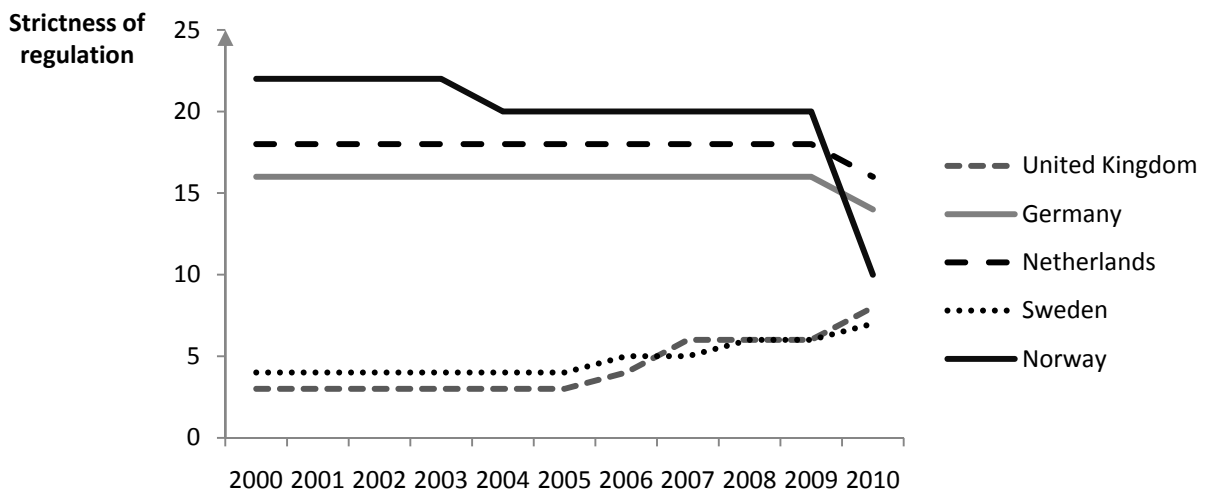


Figure 6: Level of regulatory requirements for money transfer operators

Source: Author's analysis

Figure 6 illustrates how the minimum regulatory requirements for offering money remittance services have developed in the selected countries. The weighing is based on an additive index of 15 indicators with different values¹⁹.

¹⁹ Sum of these points measures "strictness of regulation": (1) Regime: Registration=0; Licensing=2, (2) Capital requirements: None=0; Small=1; Significant=2; High=3; Very high=4, (3) Level of sanctions: None/deregistration=0; Fines/withdrawal of license=1; Criminal charges=2,(4) Entities that can provide payments: Also non-financial agents=0; Financial institutions=2; Banks only=4, (5) Fit and proper test: No=0; Yes=1,(6) Explicit experience requirement: No=0; Yes=1,(7) Check of criminal records: No=0; Yes=1,(8) Business plan: No=0; Yes=1,(9) AML-CFT programme: No=0; Yes=1,(10) Fees (on entry and annually): None:0; Low=1; High=2, [continues next page]

The figure is made for illustrative purposes only. The weighting does not claim to be a realistic representation of the financial and administrative burdens related to the various regulatory schemes. In cases where full information has not been attained, it is simply assumed that no changes have been made. Note that the levels for the Netherlands and Germany in 2010 refer to licensed payment institutions that can operate EU-wide, while the level for UK, Sweden and Norway refer to waived payment institutions, which do not enjoy that right.

Clearly, the regulatory frameworks have converged towards a middle level, meaning the most liberal regimes have become stricter, while the more rigorous regimes have become less stringent. The question of why the national policies have converged is important, and can help to explain what kind of experiences the countries have had. In that respect, it is essential to establish whether the convergence took place as a result of an EU-driven harmonization of rules, or if the national authorities learned from their own and other countries' experiences and on that basis voluntarily decided to change approach.

This section analyses the major European developments and their effect on national policies. The Third Money Laundering Directive (2005/60/EC) implied a strengthening of requirements, especially for the UK and Sweden. The UK had to introduce fit-and-proper test, checking whether owners or managers applying to register an MTO had violated regulations or had a history of bankruptcy, which would make them 'unfit' to run such a business (Kredittilsynet 2008:14; HM Treasury 2007:art.28). A British report from 2006, however, made clear that the UK faced considerable supervising challenges of the money transfer sector (HM Treasury 2006b). One could therefore speculate whether they would have implemented fit-and-proper tests regardless of the EU Directive. Sweden was in 2006 criticized in the FATF-evaluation for lack of control and limited supervision powers in this sector. As a result, the Financial Supervision Authority was given the power to conduct on-site visits to registered MTOs from April 2008 (Kredittilsynet 2008).

The Payment Services Directive was in most respects a directive that required full harmonization across Member States. However, the waiver clause (art.26) – which was particularly important for small MTOs (including Hawala-businesses) – was one of the optional components of the directive. This waiver was introduced after the UK had lobbied to the EU Commission, stating the

(11) Audit requirement: No=0; Yes=1,(12) Offsite information requirements: Low=0; High=2 (13) Onsite controls: None=0; On occasion=1; frequently=2 (14) Identification-of-customer requirement: Above high threshold=0; above lower threshold=1; All transactions=2 (15) Monthly limit on money transfers: No=0; Yes=1

concern that many of the British MTOs would no longer be able to run its business if they had to comply with the full range of requirements in the PSD (HM Treasury 2006a:35). Nevertheless, the Payment Services Directive implied a strengthening of the requirements in the UK, as the MTOs became regulated by the FSA instead of HMRC. The registration- and annual fee were both raised to £500 per firm (from £60 per premise), and the sanctioning powers for offences were broadened (FSA 2010).

In Germany one could argue that the Payment Services Directive represented a liberalization of the requirements, since it opened up for using non-financial entities as agents for MTOs. For instance, Western Union recently announced that they would expand massively in Germany and Eastern Europe as they could now use filling stations as agents for money transfers, and operate in the EU under one license (Western Union 2010). Similarly, in the Netherlands the Directive will probably open up for more use of non-financial agents, and the bank guarantee will be replaced by a capital requirement. Yet, as Germany and the Netherlands did not opt for the waiver under the PSD, the threshold for IVTS will remain high in these two countries.

The implementation of the waiver clause for small MTOs correlates with the countries that had liberal regimes in the first place, as shown in Table 11. Indeed, the one of the arguments in favour of having the waiver in the directive was to have a grandfathering clause²⁰ for the countries with a large number of registered MTOs (European Parliament 2006:67). Some countries chose to switch to more liberal regimes, while no countries opted for more stringent frameworks.

Table 11: Use of the PSD waiver clause for different countries

| Regime before PSD | Use of waiver clause | Non-use of waiver clause |
|--------------------------|--|---|
| Registration | United Kingdom, Sweden, Denmark, Finland | |
| Licensing | Norway, Ireland, Italy | Germany, Austria, Belgium, Portugal, Spain, Netherlands, France |

Source: FATF-reports; European Commission 2010

Since the waiver clause was optional, one cannot see the convergence in this field as an EU-driven top-down process. Norway, which probably had the strictest regime in place before implementation (KPMG 2003), chose to waive smaller businesses from many of the requirements, hence enabling IVTS to register and operate legally (Prop. 84L (2008-2009)). A closer analysis of

²⁰ A statute providing that one can be exempted from a new piece of legislation under certain circumstances, due to preexisting facts.

Norway seems to indicate that the developments were driven by own experiences and learning from other countries. The prosecution of nine Norwegian IVTS in the period 1999-2007 resulted in five verdicts and the sentencing of 19 people. Norwegian police (Økokrim 2007) made the following observations:

- IVTS are widely used in Norway, vulnerable to criminal activities, and an important mechanism for sending money to developing countries.
- Criminal prosecutions did not deter people from operating IVTS. Even some of those who served prison sentences continued to transfer money without having a license.
- It was suggested that more police resources should be devoted to supervision *or* that the licensing requirements were lowered.

On that basis, the Norwegian Financial Supervisory Authority was requested by the Ministry of Finance to write a report on the feasibility of using the waiver option when implementing the PSD. In that report, experiences from Sweden, Denmark, the UK and the Netherlands were outlined. They concluded that simplified requirements for IVTS would impose a considerable challenge with regard to supervision, but could under certain conditions be useful in an AML-CFT perspective since more business would be operating formally. Simplified requirements would also enable the police to prosecute MTOs that continued to operate unregistered, as there would exist legal alternatives providing money transmission to underdeveloped areas (Kredittilsynet 2008:37). In the proposition to the parliament it was emphasized that a registration model was compatible with FATF SR.VI on 'alternative remittance systems' (Prop 84L (2008-2009)).

One could see the Norwegian developments as a learning process, in which own challenges were addressed after consulting other countries. The case of government-supported web-sites with price information also illustrates the learning processes across countries. The British www.sendmoneyhome.org inspired the creation of similar pages in the Netherlands, Germany and Norway, all aiming at increasing transparency and competition in the remittance market²¹. In some way the UK can be regarded as a fore-runner with regard to regulation of IVTS. The challenge was addressed relatively early, and has led to an active approach with Remittance Country Partnerships, initiation of an interest group for MTOs (UK-MTA), a price information web-site, and a range of reports from both regulatory agencies

²¹ www.geldnaarhuis.nl, www.geldtransfair.de, www.finansportalen.no (remittance prices from autumn 2010)

and development organizations. One could argue that in the UK, IVTS has to a larger extent been treated as a development issue than in the other countries, with active involvement from DfID.

How successful have the different policies been?

All countries have faced challenges in regulating the money transfer sector and IVTS. This section reviews the findings in chapter 6 and 7, evaluating the experiences of each country. This is summarized in Table 12. There are considerable uncertainties related to these estimations, meaning that these should be treated with caution.

Table 12: Summary of control- and quality indicators

| | Communication between the regulator and the informal businesses | Proportion of unregistered money transfer operators | Proportion of unrecorded remittance flows | Prices on money transfers | Legal remittance services tailored for minority groups | Organizational innovation among MTOs |
|--------------------|---|---|---|---------------------------|--|--------------------------------------|
| UK | High | Low | Medium | Low | High | High |
| Germany | N/A | High | High | Medium | Medium | N/A |
| Netherlands | N/A | N/A | High | Medium | Low | Medium |
| Sweden | Low | Medium | High | N/A | Medium | N/A |
| Norway | Very low | High | N/A | High | None | N/A |

N/A – not available

Under both the registration regimes (UK and Sweden), there have been serious problems in communicating with the businesses, and a general concern about the lack of compliance with AML-CFT rules. It seems, however, that the UK has been more successful than Sweden in getting control of IVTS, the large number of MTOs in the UK taken into consideration. This can be perhaps be accounted for by a combination of active outreach policies, stricter sanctions for non-compliance and more devoted enforcement resources.

In the other countries communication between the regulator and the businesses has been generally absent due to the illegality of informal services. Most countries, apart from the UK, seem to have a significant share of unregistered/unlicensed MTOs. This is reflected in various remittance surveys, where a large proportion of the immigrants (typically 30-70%) claimed to use informal channels to transfer money. One could argue that it for linguistic reasons is easier for the UK to promote compliance among MTOs, than it would be in for instance Norway or the Netherlands, where the language barrier for minority groups may appear higher.

When comparing the markets it seems that the UK is best in providing cheap services and have more services tailored the various needs of different migrant

groups. The large number of MTOs in the UK reflects that there are many providers targeting specific geographical markets. In Germany and the Netherlands there seemed to be less competition and higher prices. In Norway, there was limited competition, very high prices and relatively poor accessibility of remittance services. One should note that country size probably is an important factor here. Even though Germany's requirements are relatively strict, there are still some corridor-specific MTOs, probably explained by a high number of potential customers.

One should note, however, that the quality of remittance channels is equally determined by the regulation in the recipient country. International cooperation would therefore be required to bring down all the barriers to remittance flows.

How to understand and control informal economies?

As stated earlier, this study will answer the extent to which IVTS fit the 'new view' of informal economies, listed in Table 2. Recent theory on informal economies has emphasized the complexity and resilience of informal activities, and criticized the traditional perceptions. This chapter argues that this paper's findings about IVTS are largely compatible with the characteristics outlined in the UN Working Paper (Chen 2007).

Use of IVTS

The widespread use of IVTS seems to persist, despite of economic and technological developments. Accurate numbers on the scale of IVTS is naturally hard to present, but various remittance surveys from the countries included in this study all suggest that the use of informal channels is widespread. Surveys in Germany, the Netherlands and Sweden showed that the proportion of migrants preferring informal channels hovered around 50%. Technological developments for instance within telecom and internet payment systems, do not seem to have crowded out the use of IVTS. Rather, there is evidence indicating that many MTOs have used modern technology to their advantage to improve the effectiveness of their payment systems and offer new services. For instance, the Somali money transmitter Dahabshiil has online transfer systems in place, and is currently working to introduce a web-based debit card in Somaliland (Dahabshiil 2010; Voice of America 2010).

Importance of IVTS services

The importance of IVTS is more than marginal and informal services seem to fill a gap that is not met by formal institutions, for instance in providing a

financial lifeline to areas with poor infrastructure. The widespread use of IVTS, despite its illegality in many countries, underlines this point.

Integration with formal institutions

IVTS are not operating in a separate economic sphere, but use and provide services for formal institutions. Larger Hawala-operations rely on using regular bank accounts in order to settle the accounts between the operators. In the UK where these businesses are registered, complaints about the banks' reluctance to offer bank accounts to MTOs have been taken to the Office for Fair Trading (Interview UK Money Transmitters Association, 18/6/2010). Settlement of accounts can also happen by combining it with a formal firm, such as an export/import business (El-Quorchi et al. 2003), and delivery of funds can take place through mainstream businesses, such as bus companies (De Luna-Martinez et al. 2006). In certain conflict areas also formal institutions (such as the United Nations and humanitarian organizations) use IVTS to transfer money (Zagaris 2007:160). In the Netherlands, we have seen strategic partnerships where (unlicensed) Somali MTOs are used to carry out payments on behalf of MoneyGram (Mohogu 2006). Linking this to the definitions of informal economies listed on page 18, it appears that IVTS in some respects differ from country to country. In Sweden and the UK these are normally registered and regulated, pay taxes, inform the authorities about their turnover and keep records of the transactions, while IVTS operate underground in Germany, the Netherlands and Norway. Yet, these businesses are similar in that they are normally small-scale, self-employed and based on social networks, in all the countries they operate. Moreover, most IVTS are keeping some kind of transaction records, but only in the countries where they operate legally these are readily available for the authorities.

One should bear in mind that the prime responsibility of detecting and reporting of suspicious transactions (STRs) lies with the financial institutions themselves (Verhage 2007, cited in Vande Walle 2008). For instance the FATF-evaluation of Norway (2005) revealed that one licensed Norwegian MTO had completely neglected its reporting obligations. So, also in the 'formal' sphere there is a reliance on self-regulation and trust between the business and the regulator.

Motivation for operating informally

The main motivation for operating outside the regulated sphere seems to be that the threshold for entry is too high. Most MTOs seem willing to comply with basic regulation (primarily concerning AML-CFT), but rigorous ex-ante controls and high capital requirements can prevent many MTOs from licensing. As seen in Table 13, the number of MTOs (in absolute and relative

terms) is clearly related to the level of regulatory requirements outlined earlier in this paper.

Table 13: Number of registered/licensed MTOs

| | Registered/licensed MTOs | |
|-----------------------|--------------------------|-------------------------|
| | Number | Per million inhabitants |
| United Kingdom | 2 150 | 34,9 |
| Sweden | 75 | 8,2 |
| Netherlands | 30 | 1,8 |
| Germany | 39 | 0,5 |
| Norway | 2 | 0,4 |

Several Hawala-operators in Norway have contacted the Norwegian Financial Supervisory Authority with the intention of having their businesses licensed (Kredittilsynet 2008:6). This can indicate that there was a general willingness to operate legally among the informal providers, but that the threshold was too high. One should remember that many of the larger Hawala businesses operate formally in some European countries, and informally in others. This illustrates the important theoretical point that the degree of informality is determined by the “boundaries of state regulation” (Sassen 1991:80, cited in Vande Walle 2008). More than referring to the characteristics of these activities, the labels formal and informal are effectively defined by where the threshold for registration is set by the government.

Importance of economic policy

Many IVTS seem to be consisting of stable and dynamic businesses; hence they are highly affected by economic policies. That does not only refer to policies that deal with money transmission directly. As Maimbo (2003:5) notes the “formal and informal financial systems benefit from their mutual deficiencies and each tends to expand when the condition of the other is impaired”. Complex regulations and fixed exchange rates will therefore increase the demand for remittance services offered outside the regulated sphere.

Implications for regulation

The previous section presented an updated view on informal economies, consistent with the theoretical perspectives outlined in the UN Working Paper (Chen 2007). Which implications does that have for policy makers?

The first implication should be that since the use of IVTS seems to persist despite of general modernization, and considering the possible abuses of such systems, an active approach is needed. Since the quality of these services has a significant impact on the social situation for migrant workers and their

relatives back home, policy makers should take into account what consequences the regulatory framework has for the consumers.

Another implication is that since there is no clear line between formal and informal businesses in the way they operate, there is a potential for registering businesses, while allowing them to make use of some the 'informal' characteristics of their business operations. For instance, registered business can apply AML-CFT procedures, but still take advantage of the social capital embedded in the networks. This social capital can, as described in the introduction, reduce overhead-expenses, reinforce trust between customers and MTOs, enable wide distribution networks, and many of the other features that IVTS are known for (Hernes 2007). A registration regime can also serve as an incentive for MTOs to integrate closer with other financial services (for instance by settling accounts of MTO via regular bank transfers), address a wider range of customers (outside own ethnic community) and enter into partnership with larger MTOs.

Furthermore, there seems to be a group of MTOs that are willing to register/license, but at the time are unable to. One should therefore make sure that requirements imposed are proportionate to the risks they intend to prevent and do not impose overly excessive burdens on the businesses. It is important to be aware that the choice to operate informally is not only a choice made by the business, but also by the government since they are setting the threshold for operating as a regulated MTO.

CONCLUSION

The aim of this paper was to answer how governments could bring IVTS under control without eliminating its advantages. The previous chapters have presented empirical findings from the five countries as well as theoretical considerations on how to regulate IVTS. It is clear that all the countries have faced challenges in that regard, and that lack of information makes it hard to present an accurate picture of how well IVTS are controlled. Still, five important insights can be presented.

First, the demand for, and use of, informal services seems to be rather constant, regardless of regulatory regime. The proportion of migrants using informal services is high also in the countries where this is illegal. Furthermore, physical transport of cash on behalf of friends and relatives is still a normal way of transferring money. This illustrates that many migrants are not satisfied with the services offered by regulated MTOs and banks, be it for high prices, lack of convenience or social reasons.

Second, the markets seem to deliver both cheaper and more tailored remittance services when the requirements are more lenient, owing to a larger number of firms in the market and lower overhead costs. Hence, in order to ensure good remittance services, governments should probably opt for some kind of registration regime. This would enable more actors to enter the market and offer corridor-specific services to a competitive price.

Third, the findings in this study suggest that many IVTS are both willing and capable of registering as long as the requirements are not too rigorous. Informal businesses would in many cases welcome efforts to lower the barriers to entry, and there is reason to expect that if they become regulated, they would become more professional and integrated with the rest of the economy over time. This finding is consistent with the new view of informal economies presented in Chen (2007). The often-used distinction between 'formal' and 'informal' is misleading and tend to ignore that many informal businesses are well organized and highly integrated in the formal economy. As many businesses operate as registered entities in some countries, and underground in others, policy makers should realize that they themselves define the boundaries of formality.

Fourth, evidence from the UK and Sweden shows that considerable efforts would be required to ensure compliance with AML-CFT regulations. A registration regime is no panacea, and would necessitate resources for supervision and enforcement, sanctions for non-compliance as well as efforts to reach out to minority groups. Still, a 'light touch approach' appears to be the only viable option in bringing IVTS under control.

Finally, the developments in the regulatory frameworks for remittance services suggest a pattern of converging national policies. In the countries that were most stringent one should expect more competition due to the general lowering of requirements by the PSD, and for Norway, also by the introduction of a simplified authorization for IVTS. IVTS in the two registration regimes, on the other hand, have gradually been put under more scrutiny.

The effects of the new legal frameworks are still not visible, but will in the future bring important new insights in how to regulate informal value transfer systems.

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Regulation of Informal Value Transfer Systems

The attention for informal remittance systems increased sharply after the 9/11 attacks in 2001. The lack of records and government control of these systems have raised concerns about the vulnerability with regard to terrorist financing, money-laundering and other financial crimes. Still, these informal mechanisms seem to persist as they offer advantages in terms of speed, price, accessibility and familiarity. National authorities differ significantly in how they address money remittance providers, in terms of the requirements they impose, how these are enforced and

sanctioned, and in the range of complementary policies. This study compares the regulatory approach of five remittance-sending countries, namely the UK, Germany, the Netherlands, Sweden and Norway. It assesses the level of control the national authorities have, as well as how efficient the market functions for the consumers.

In doing that, the study tries to answer how the regulators can strike a balance between combating the abuse of informal remittance systems and safeguarding the legitimate uses of these systems. In addition

to answering the question on an empirical basis, recent theory on informal economies is consulted. The EU Payment Services Directive, implemented in 2009/2010, introduced significant changes to the national regulatory frameworks, which are also discussed in this paper.