Hawala's Charm: What Banks Can Learn From Informal Funds Transfer Systems

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HAWALA’S CHARM: WHAT BANKS CAN LEARN FROM INFORMAL FUNDS TRANSFER SYSTEMS

ABSTRACT

Hawala networks, or Informal Funds Transfer Systems (IFTS), are age-old means of conducting cross-border financial transactions. They thrive in regions where there is inadequate or nonexistent financial infrastructure due to poverty, daunting geography, or endemic conflict. Such regions are home to poor and underserved communities hungry for and in desperate need of financial services. IFTS provide access to these relatively ignored markets through the use of specific transactional mechanisms, payment modalities, and clearing and settlement options. With these innovative and flexible techniques, IFTS have successfully tapped into the exponentially growing global remittance market. Hawala networks are also used by NGOs and humanitarian aid organizations operating in post-conflict regions, and by diaspora communities looking to provide vital services for family members in their country of origin. IFTS, however, can also be illegitimately used for smuggling, capital flight, or terrorist activities. Formal financial institutions can learn how to better access the remittance market and serve remote or poor communities by learning from the key operational characteristics that make IFTS so successful: speed and efficiency, accessibility and adaptability, affordability, anonymity, cultural sensitivity, and relational contracts. Understanding these operational characteristics can allow for innovative, Hawala-inspired inclusion techniques to be incorporated into the formal infrastructure. Mobile banking, adaptive financial procedures and services, broad integration, and a shift in the banking culture would not only allow for formal financial institutions to gain access to the lucrative remittance market, but would also improve access to financial services for the poor and underserved.
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Introduction

Informal Funds Transfer Systems (IFTS), commonly called Hawala networks, are age-old methods of conducting financial transactions across various borders and cultures using a system of trust and social investment. IFTS thrive in regions where formal financial institutions dare not or cannot succeed.¹ IFTS do not operate in the shadowy leftovers of the formal regime,² but rather enjoy prime access to the growing multi-billion dollar domestic and international remittance market.³ By understanding the operational characteristics that make IFTS so successful, formal banking institutions can learn how to successfully operate in warring, post-conflict, and developing regions, thus gaining access to a wider market of individuals.⁴ Through the use of innovative financial inclusion techniques inspired by Hawala networks, formal institutions can become more competitive in the remittance market, and can help provide access to financial services in the poor and underserved regions of the world.⁵

This Note will not attempt to criticize the various regulation mechanisms put in place to shut down, outwit, or destabilize the many existing IFTS, specifically Hawala as operated in the Middle East. Nor will this Note discuss in great detail the connection such informal systems have to black market or terrorist activities. There is a plethora of well-written and well-researched literature that covers both topics substantially.⁶ Rather, this Note will attempt to: (1) explain the characteristics that make IFTS so successful, and (2) identify lessons that formal banking institutions can learn from such systems in order to be more competitive in the lucrative remittance market. In turn, this analysis can give formal institutions the tools needed to provide increased access to financial services for poor and underserved communities in regions previously deemed uneconomical or inaccessible.

Part I of this Note will provide background information on the various Informal Funds Transfer Systems, or Hawala networks, that cross ethnic and state boundaries.⁷ Part II will describe the basic transaction mechanisms and payment modalities that are used by IFTS.⁸ Part III will discuss

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¹ See infra Part I.A.
² See infra Part II.B.
³ See infra Parts IV.A, V.
⁴ See infra Part V.
⁵ See infra Part VI.
⁶ See infra note 136.
⁷ See infra Part I.
⁸ See infra Part II.
the various clearing and settlement options, both complex and simple, that IFTS use to settle debts and balance payments. Part IV will briefly describe the four most common uses for IFTS: remittances; NGOs and humanitarian aid assistance in conflict regions; international services for diaspora communities; and illegitimate uses, such as smuggling and capital flight. Part V will analyze the operational characteristics that make IFTS so successful in the remittance market. Part VI will propose programs, inspired by the key characteristics of IFTS, that formal financial institutions can implement as a means of competing for the remittance market and improving financial access to the poor in post-conflict and remote regions.

I. INFORMAL FUNDS TRANSFER SYSTEMS BACKGROUND

A. Definition

Hawala-type networks, or Informal Funds Transfer Systems, have been known across time and cultures by many different names, and they continue to successfully operate in all parts of the world. The World Bank and IMF have been explicit in using the term “Informal Funds Transfer Systems” for very specific reasons. The first reason is that such systems often function as the primary means of conducting financial transactions in many areas of the world; therefore, referring to IFTS as “alternative remittance systems” would be inaccurate. Second, the term “underground banking” is misleading because in communities where IFTS prosper, the systems frequently function openly, though not necessarily with formal or political acknowledgment. Third, as this Note will discuss in Part I.B infra, Hawala systems cross many borders, cultures, and religions, so referring to them as “ethnic banking” is unnecessarily restric-

9 See infra Part III.
10 See infra Part IV.
11 See infra Part V.
12 See infra Part VI.
15 Id.
16 Id.
Fourth, the term IFTS more accurately reflects the fact that these systems operate using modalities very similar to those used in “conventional” or “formal” banking systems. Finally, though only inferred by the World Bank and IMF, terms like “underground banking” merely enforce the negative stereotypes and connotations that have been associated with Hawala-type networks since September 11, 2001. It is for these reasons that this Note will only refer to such systems as Hawala, or IFTS, in order to avoid the negative connotations and confusing images created by other illegal transactions that often receive the same label.

Hawala in Arabic translates to “transfer,” and in Hindi it means “trust,” or a valuable item that is passed on to a trusted party for delivery. It is important to keep in mind that though this Note will use the term “Hawala” to represent IFTS, the term is used in some countries to refer to formal money transfers in commercial banking. The most common reference to Hawala, however, is in reference to informal financial systems.

B. Historical Context

IFTS existed long before formal banking, and they will continue to exist as banks rise and fall in various nations. Across the board, the primary purpose of Hawala-type transfer systems has been to facilitate trade between distant regions. The origins of these systems can be murky at times, but regardless of where the systems are centrally located, they tend to share a few common characteristics.

I. Institutional Basis

Before discussing the specific informal financial systems of ancient and medieval commerce, it is important to understand the institutional
developments that allowed for such systems to exist successfully. The majority of pre-modern merchants found themselves traveling through and operating in environments that lacked the formal mechanisms needed to conduct complex long-distance business transactions. Alternatively, where such formal systems did exist, “the state as an institution that enforce[d] contracts and property rights and provide[d] public goods pose[d] a dilemma: [for a] state with sufficient coercive power to do these things also had the power to withhold protection or confiscate private wealth.” Essentially, businessmen of the pre-modern world were left struggling with commercial systems that were incomplete, incapable of providing a working formal system, or subject to a political regime of the strength or corruptibility that would significantly decrease the merchants’ profit margin—a high price considering the means of travel at the time. Furthermore, if there was a formal system in place, it was often restricted to a particular tribal region, and the resulting “transaction radius within which business could be conducted under [a] protective wing ... was ... narrow.” When a merchant stepped outside this protective sphere, he was once again subject to the dangers mentioned above.

Another impediment to the pre-modern transaction was the limited means of payment available across communities. Because hard currency, such as silver or gold bullion, was not readily available to everyone, and because reliance on a barter system subjected merchants to additional risks, a new means of transactional arrangement needed to be developed.

2. China

The Tang Dynasty of 618–907 created an informal financial transfer system known as the Fei-ch’ien, or the Flying Money System. The Tang developed it as a means to cope with its robust economy, specifically the transference of tax revenues. The use of the Fei-ch’ien did not end with the fall of the Tang Dynasty. Between 1368 and 1644, the Ming Dynasty began to decrease its use of paper money, and instead used the now-classic informal remittance system for the majority of its financial transfers.

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25 Schramm & Taube, supra note 22, at 406.
26 Id.
27 Id.
28 Id.
29 Id. at 406–07.
30 JOINT IMF-WORLD BANK PAPER, supra note 14, at 10.
31 Id.
32 Id.
Ch’ing Dynasty continued to develop the system from 1644 to 1911. Fei-ch’ien played a crucial role in the cotton trade when a cotton dyestuff network began to include money transfers in its services repertoire; as more dyestuff stores began to do the same, a “China-wide network” formed.

The Fei-ch’ien was especially useful in both the tea trade and as foreign actors expanded into China. As a means of avoiding foreign-controlled financial intermediaries and colonial powers, “money changers, gold dealers, and trading companies” used the informal system to prosper under colonial repression.

3. India

India’s ancient informal financial system, now illegal but still in use, is known as Hundi. Early forms of bills of exchange and other promissory notes appear to have been the primary means of conducting pre-modern Hundi transactions, because there has been no evidence found of paper money or negotiable instruments in ancient India.

Hundi was developed under a “strong body of rules, usage, and customs” that received government recognition, so much so that these bills of exchange were circulated amongst Indian bankers for intrastate trade, integrated into the modern banking system, and defended on occasion by the courts on behalf of the business community. It was only after the infamous Jain Hawala scandal, in which bribes and political corruption dominated the headlines in the 1990s, that Hundi became completely illegal. Prior to the scandal, the local Hundi customs and usages were still permitted by the legislature.

Hundi spread north from the subcontinent as traders conducted business with India’s neighbors, specifically Iran, Pakistan, and Afghanistan. It is possible that Hundi’s use began to spread north during the time of the

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33 Id.
34 Id.
36 JOINT IMF-WORLD BANK PAPER, supra note 14, at 10.
37 Id.
38 Id. at 11 box 4.1.
39 Id.
40 Id.
41 Id. at 10 n.12, 11 box 4.1.
42 JOINT IMF-WORLD BANK PAPER, supra note 14, at 11 box 4.1.
43 Id. at 10.
Mughal Empire.\textsuperscript{44} Informal transfers became particularly important when currency export between India and Pakistan was made illegal around the time of the 1947 partition.\textsuperscript{45}

4. Europe

In Europe, the development of banking activity can be credited in part to the prevalent use of bills of exchange, which are “an obligation in the form of a payment order addressed to the [payee].”\textsuperscript{46} Bills of exchange were first widely used in Italy during the fourteenth century by money exchangers conducting remittance transactions.\textsuperscript{47} Towards the end of the sixteenth century, bills of exchange spread through France and England as a means of facilitating domestic trade and personal transactions.\textsuperscript{48}

5. Middle East

The Muslim-majority world is most commonly associated with Hawala, especially after Americans became aware of the word following 9/11.\textsuperscript{49} Perhaps contrary to popular belief, the history of Hawala in the Middle East and Arabic world has not been well documented.\textsuperscript{50} The primary purpose of Hawala was to assist in trading with multiple regions, within fiefdoms of varying distances, and between areas of varying terrain.\textsuperscript{51} Scholars suggest it evolved specifically to avoid robbery along the silk trading route.\textsuperscript{52} Another theory is that it developed when the South Asian diaspora communities in pre-modern East Africa needed a means to settle accounts.\textsuperscript{53}

The term Hawala, as a legal concept, can be found in Arabic texts dating back to 1327.\textsuperscript{54} While it began as a classic delegation of payment or transfer, various contractual obligations and parameters began to take

\textsuperscript{44} Pathak, supra note 35, at 2011.
\textsuperscript{45} JOINT IMF-WORLD BANK PAPER, supra note 14, at 10 (“[A]fter ... 1947, virtually no payment connected with trade with India and Pakistan was transacted through banks.”).
\textsuperscript{46} Id. at 11.
\textsuperscript{47} Id.
\textsuperscript{48} Id.
\textsuperscript{49} See, e.g., Wilson, supra note 19, at 1–2.
\textsuperscript{50} JOINT IMF-WORLD BANK PAPER, supra note 14, at 11.
\textsuperscript{51} Id.
\textsuperscript{52} See Pathak, supra note 35, at 2011 & n.17.
\textsuperscript{53} JOINT IMF-WORLD BANK PAPER, supra note 14, at 11.
\textsuperscript{54} Schramm & Taube, supra note 22, at 407.
shape in accordance with developing Islamic legal traditions. This allowed Hawala to expand its scope beyond the relatively common hard currency issues of the pre-modern Middle East, and into an institution built to decrease the uncertainties and risks involved in cross-border dealings.

C. Common Aspects

As mentioned, although the word Hawala is most often associated with the Middle East and Muslim communities, the various informal funds transfer systems all share similar key traits. The first is that such informal transactions almost inevitably cross international lines. The second characteristic, a logical conclusion of the first, is that such transactions will involve more than one currency. Third, the transactions involve principal and intermediary parties who have a financial position in core and peripheral transactions.

II. TRANSACTION MECHANISMS

A. Basics

From simple to complex, an informal funds transfer involves a specific set of parties who vary in number based on the complexity and sophistication of the transaction. The “hawaladar” is the broker, money remitter, or money exchange dealer whom the client contacts in order to initiate a transfer. Clients range from businesses to individuals. The classic example involves an immigrant in Country A seeking to send money back to his family overseas in Country B. The hawaladar in Country A receives the money from the client, in addition to a small fee for his services. For the street exchange value of the amount given, Hawaladar A contacts his

55 Id.
56 Id.
57 Wilson, supra note 19, at 2.
58 Id.
59 Id.
60 Schramm & Taube, supra note 22, at 410.
61 Used interchangeably with the term broker throughout this Note.
64 Wilson, supra note 19, at 8.
associate in Country B, generally via phone or email, to communicate the password, amount, and even payment location.\(^{65}\) A then provides his client with a code or password, which the client then passes along to the receiving party.\(^{66}\) Hawaladar B will then release the funds to the party providing the code or password.\(^{67}\) Once A has passed along the information to his counterpart, A’s part in the transaction is complete, and usually any written records are eliminated to preserve the privacy of the parties.\(^{68}\) B will do the same once payment has been issued.\(^{69}\) On average, a Hawala transaction will take less than twenty-four hours to complete.\(^{70}\)

Even though no hard currency has been transferred across state lines, the transaction still does not result in a mysterious movement of money as the headlines like to depict.\(^{71}\) Informal transfers have similar accounting details to international transactions occurring through formal banking channels; the only difference is that one transaction is regulated and the other is not.\(^{72}\) In fact, many informal funds transfers indirectly involve the formal system. Although the hawaladar “does not depend on a complicated infrastructure” in order to conduct his business, he often uses an “officially established checking account” associated to his name or small business.\(^{73}\) A majority of international hawaladars hold at least one or two accounts with formal financial institutions.\(^{74}\) This account is where the hawaladar deposits the client’s funds or withdraws funds for the beneficiary.\(^{75}\) For all intents and purposes, the hawaladar’s designated bank account functions and acts as a bank financing the informal transactions.\(^{76}\)

B. Payment Modalities

The payment modalities involved with informal transactions are also very similar to formal international transactions. It is rare for physical cash

\(^{65}\) Schramm & Taube, *supra* note 22, at 408.
\(^{66}\) Nakhasi, *supra* note 62, at 477.
\(^{67}\) Id.
\(^{68}\) Schramm & Taube, *supra* note 22, at 408.
\(^{69}\) See id.
\(^{70}\) Id.
\(^{71}\) See JOINT IMF-WORLD BANK PAPER, *supra* note 14, at 14 (discussing the misleading assertion that informal transactions result in money submerging on one side and popping out in a village across the world).
\(^{72}\) Id.
\(^{73}\) Schramm & Taube, *supra* note 22, at 408–09.
\(^{74}\) Maimbo, *supra* note 62, at 7.
\(^{75}\) Id.
\(^{76}\) See Schramm & Taube, *supra* note 22, at 409 (discussing “bank within a bank” assertions).
to move across borders in either formal or informal transfers. For example, when conducting a remittance payment or international transfer, be it through one’s bank or Western Union, no physical funds are moved. Instead, the transaction can be described as follows:

[T]ransmission of a payment order is ... based on a receipt of some funds at the remitting end of the transaction. Actual payment is made to the beneficiary out of balances at the receiving end; settlement follows or, in cases where there are no exchange control issues, institutional accounts can be debited/credited ....

Again, no physical money is being moved, yet the public does not deem such transactions as mysterious or underground, even though “neither formal nor informal financial systems necessarily transfer funds from one jurisdiction to another. Instead they depend on a sequence of accounting debits and credits among accounts kept by a network of individuals, companies, accountants, [and other relevant parties].”

In the formal system, these types of exchanges are known as Balance of Payment Accounts, because the transaction is “intrinsically paired with an international capital flow.” The ability for a client to send funds internationally is enabled by the fact that there are two parties willing to finance the remittance transaction through cross-border asset and liability exchanges. The same willingness must exist in the informal systems, except that the willing parties are individuals rather than formal institutions or banks.

III. CLEARING AND SETTLEMENT OPTIONS

A. Consolidation: Retail versus Wholesale Brokers

Because most informal funds transactions are rather complicated, and because of the imbalances that result on the hawaladars’ accounts—especially when handling remittances—a multi-tiered system has evolved within the various IFTS. Frequently, “[i]ndividual ‘retail’ hawaladars settle their balances with a local ‘wholesale’ hawaladar who eventually balances the consolidated local transfer balance with his counterparts in other localities.” This allows for the balance of sums on the account to

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78 Maimbo, supra note 62, at 8.
80 Id.
81 Id.
82 Id.
be cleared.\textsuperscript{83} Wholesale broker (hawaladar) set-ups are especially useful in cases where the incoming and outgoing payments between brokers are from numerous remittance transactions.\textsuperscript{84} For example, during the 1990s, the Xawilaad\textsuperscript{85} of Somalia were incorporated as franchises into the agent networks of larger enterprises that specialized in money transfers.\textsuperscript{86} This created a centralized hub in which to consolidate and settle debts.\textsuperscript{87}

The development of wholesale brokers indicates a vast network that has found a means of consolidating accounts in order to streamline the cost of settlement. In fact, where “regulatory environments and market size permit, there has been a growing ‘professionalization’ and development of the larger [ wholesale] enterprises.”\textsuperscript{88} It would be rather costly for small-scale operators, functioning in multiple continents, to deal with countless small positions, both incoming and outgoing.\textsuperscript{89} The wholesale hawaladars consolidate the small positions into larger subtotals, and then conduct business with other large-scale hawaladar operations.\textsuperscript{90} The IFTS have developed various settlement procedures to further handle the account balances described above.

\textbf{B. Simple Reverse Transaction}

A simple reverse transaction is a basic tit-for-tat transaction in which incoming equals outgoing, but such easy balancing rarely occurs for two reasons. First, as mentioned previously, there is a “low probability that Hawala remittances from Country B to Country A would pass through the same hawaladars” as another remittance traveling from Country A to Country B.\textsuperscript{91} The second, more relevant reason, is that aggregate remittance flows are largely asymmetrical between countries.\textsuperscript{92} Countries with

\begin{itemize}
\item \textsuperscript{83} Id. at 408.
\item \textsuperscript{84} Id. at 408 \& n.1. For example, a U.S.-based hawaladar is unlikely to be able to balance his account from income transfers with his hawaladar counterpart in Somalia, because the influx of funds from Somalia to the U.S. would not be at an equivalent rate.
\item \textsuperscript{86} Id. at 523.
\item \textsuperscript{87} Id.
\item \textsuperscript{88} Id. at 533.
\item \textsuperscript{89} Wilson, \textit{supra} note 19, at 6.
\item \textsuperscript{90} Id. The IMF and World Bank are unclear on how to classify these larger operations; in fact, some experts believe they should not be classified as hawaladars. Id. (discussing how in Dubai these wholesale hawaladars are referred to as “exchange houses”).
\item \textsuperscript{91} JOINT IMF-WORLD BANK PAPER, \textit{supra} note 14, at 14.
\item \textsuperscript{92} Wilson, \textit{supra} note 19, at 7.
\end{itemize}
large immigrant populations or migrant workers are the logical sources of net remittances, and countries with large emigrant populations are the natural recipients of net remittances. For example, the United States will have large outflows, and Latin American countries will have large inflows, but aggregately, it is unlikely that Latin American countries will experience large outflows and the United States will experience large inflows.\textsuperscript{93}

C. Complex Reverse Transaction

Complex reverse transactions are an option commonly used when transactions involve a country that is subject to costly exchange controls or currency restrictions.\textsuperscript{94} These transactions incorporate the idea of a multi-tiered system.\textsuperscript{95} An illustration of this system is as follows: Broker $A$ has an unsettled position with Broker $B$. $B$ receives local currency from his client, who wants to send it to Country $C$. However, $B$ is unable to complete this transaction for a variety of reasons, the most common of which is an unfavorable exchange rate.\textsuperscript{96} To solve this problem, $B$ would need the assistance of an outside party. $B$ could, for example, seek help from $A$, if $A$ is able to recommend a broker in Country $C$. In such a case, $A$ is usually an associate of the broker in Country $C$, or knows Broker $C$ due to an unsettled position between the two from a previous transaction.\textsuperscript{97} $A$ can instruct $C$ to have the funds available for $B$, or $B$ can deal directly with $C$, and can instruct $A$ to settle the transaction. This would avoid the currency control issue and would clear the initial position between $A$ and $B$.\textsuperscript{98}

D. Bilateral Settlement

1. Financial Settlement through Banks

A bilateral financial settlement through a bank rarely happens, but if one were to occur, Hawaladar $A$ would deposit money directly into Hawaladar $B$’s account in order to clear an earlier position or debt.\textsuperscript{99} The bank’s foreign exchange rate, however, would be triggered by this action, because

\textsuperscript{93} \textit{J}OINT \textit{I}MF-WORLD \textit{B}ANK \textit{P}APER, \textit{supra} note 14, at 14.
\textsuperscript{94} Wilson, \textit{supra} note 19, at 7.
\textsuperscript{95} Schramm & Taube, \textit{supra} note 22, at 408 n.1.
\textsuperscript{96} Wilson, \textit{supra} note 19, at 8.
\textsuperscript{97} \textit{J}OINT \textit{I}MF-WORLD \textit{B}ANK \textit{P}APER, \textit{supra} note 14, at 15.
\textsuperscript{98} \textit{Id}.
\textsuperscript{99} \textit{Id}.
the banks are in different countries. The more common method of conducting a bilateral settlement would be for \( A \) to simply deposit the initial client’s money into \( B \)’s foreign account.

2. Settlement through Import/Export Clearing

Settling through import/export clearing is similar to bilateral settlement through a bank, but it involves the import/export of goods. Such bilateral trade can manifest in a few ways. During the initial transaction, after receiving the client’s funds, Hawaladar \( A \) could simply send goods to Hawaladar \( B \). These goods, such as jewels, gold, or electronics, would amount to the payment \( B \) makes available to the beneficiary. \( A \) could also, in a later transaction, finance imports to Country \( B \) or pay for the imported goods. As a result, exports from Country \( A \) to Country \( B \) are paid for by the balances due between Hawaladars \( A \) and \( B \). For example, at the end of the month, if an outstanding balance exists between \( A \) in Afghanistan and \( B \) in Australia, \( B \) can use a Japanese bank account to purchase cars for export to Afghanistan. Once the cars arrive, they would be transferred to \( A \)’s care, and \( A \) can sell them for profit. This transaction would thus clear the outstanding balance between the two parties.

E. Multilateral Trade

Similar to the bilateral importing or exporting of goods to balance accounts, multilateral trading of goods incorporates the wholesale, large-scale operators mentioned above. Multilateral trade can manifest itself in countless scenarios. An example would be when Broker \( A \) pays, on behalf of Broker \( C \), for a series of wholesale exports sent from Country \( C \) to Country \( B \). Another such scenario could involve Broker \( B \) transferring his claim with \( A \) to an associate in Country \( D \). Because \( B \) has an open position with \( D \), \( A \) will send the exports to \( D \), thus clearing both balances. Such transactions can become increasingly complicated and create a robust influx of goods into a market, but each time they result in a chain of transactions that are entirely invisible to financial regulations.

\[^{100}\text{Id. app. 1 at 30 tbl.A1.2.}^{101}\text{Id. at 15.}^{102}\text{Schramm & Taube, supra note 22, at 408.}^{103}\text{Joint IMF-World Bank Paper, supra note 14, at 15–16.}^{104}\text{Wilson, supra note 19, at 8.}^{105}\text{Maimbo, supra note 62, at 6 box 1.}^{106}\text{Joint IMF-World Bank Paper, supra note 14, at 16.}^{107}\text{Id.}\]
F. Misstatement and Over/Under Invoicing

The misstatement of trade values on invoices is a means of settlement that involves over- and under-invoicing import/export transactions. Rather than concealing an import, as occurs in smuggling, the imports are recorded under value, thus reimbursing a hawaladar with an open position. In addition, “the importer [or hawaladar] in Country B may also benefit from reduced tariff payments,” which can help slowly clear the accounts between Hawaladar B and Hawaladar A. Over numerous transactions, the positions will eventually balance out as the over- and under-invoicing of goods slowly benefits one or both hawaladars.

G. Smuggling

The next logical means of settlement by trade is smuggling. This Note will go into more detail about the smuggling opportunities some IFTS offer, but the simplicity of smuggling mechanisms warrants brief mention. For example, should Hawaladar B be entitled to a specific quantity of goods after a transaction with Hawaladar A, A can settle the balance by accepting the risk and smuggling the goods into Country B on behalf of Hawaladar B.

H. International Services

One of the most common settlement options is the provision of international services, such as travel, medical treatment, or educational funds. Hawaladar B provides these services to the beneficiaries in Country B, or to himself, but the services are financed by Hawaladar A, a client, or one of the consolidated wholesalers mentioned above. The purchasing of services provides another means to avoid currency controls, because a client or hawaladar can opt to purchase the services with local currency rather than dealing with the hassles of currency controls.

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108 Id.
109 Id.
110 See infra Part IV.D.
111 JOINT IMF-WORLD BANK PAPER, supra note 14, at 16.
112 Wilson, supra note 19, at 8.
113 JOINT IMF-WORLD BANK PAPER, supra note 14, at 16.
114 Id.
I. International Investment and Capital Flight

The final method of settlement that brokers can use to clear balances is through international investment. For example, rather than Hawaladar $B$ having a foreign bank account, $B$ and his partners can purchase various assets, such as bonds, stocks, or real estate.\footnote{115 Id.} The purchases are made in exchange for the balance owed by Hawaladar $A$, and $A$ pays for the assets in the name of $B$ or $B$’s partners.\footnote{116 Id.} Such transactions represent yet another intersection between formal and informal transfer systems. Furthermore, they illustrate the most common method used to engage in capital flight, because “the [final holder] of services or assets never actually purchases foreign exchange.”\footnote{117 Wilson, supra note 19, at 9.} This settlement method is commonly used in countries where citizens are restricted or prohibited from owning foreign assets.\footnote{118 Joint IMF-World Bank Paper, supra note 14, at 16.}

IV. Uses

IFTS provide a variety of uses, and offer a diverse set of both legitimate and illegitimate services, depending on the region and value being transferred. The most common legitimate uses for IFTS are remittances, NGO or humanitarian aid, and services. Illegitimate uses encompass capital flight, black market dealings, evasion, and terrorist activities.

A. Remittances

Remittance transactions occur primarily in countries with large immigrant or migrant worker populations.\footnote{119 See id. at 12.} IFTS serve as a cheap and convenient means for immigrant families to send money to relatives in their country of origin, or for migrant workers to send money to family in more remote parts of the state.\footnote{120 Id.} Afghanistan alone has nearly 30% of its population externally and internally displaced, and remittances from outside of Afghanistan are received by about 15% of the rural population, which is 20% of their average expenditure.\footnote{121 Samuel M. Maimbo, The Challenges of Regulating and Supervising the Hawaladar of Kabul, in Regulatory Frameworks for Hawala and Other Remittance Systems 47, 52 (Int’l Monetary Fund 2005), available at http://siteresources.world} These transactions are often small

\footnote{115 Id.} \footnote{116 Id.} \footnote{117 Wilson, supra note 19, at 9.} \footnote{118 Joint IMF-World Bank Paper, supra note 14, at 16.} \footnote{119 See id. at 12.} \footnote{120 Id.} \footnote{121 Samuel M. Maimbo, The Challenges of Regulating and Supervising the Hawaladar of Kabul, in Regulatory Frameworks for Hawala and Other Remittance Systems 47, 52 (Int’l Monetary Fund 2005), available at http://siteresources.world}
enough that banks would not generally view them as profitable endeavors.\footnote{22} Companies like Western Union are the formal options for transmitting remittances, but unlike IFTS, Western Union has limited access to remote and war-torn areas.\footnote{23}

B. NGOs and Humanitarian Aid

Organizations that operate in emerging conflict, warring, or post-conflict regions must make use of the local IFTS in order to fund and conduct relief operations.\footnote{124} Essentially, these transactions act like large-scale remittances.\footnote{125} Transporting large amounts of physical cash is often expensive, dangerous, and logistically impossible.\footnote{126} In countries where humanitarian relief and post-conflict reconstruction operations are occurring, the formal banking systems are non-existent, destroyed, corrupt, or non-operational.\footnote{127}

For example, in Kabul during and after the Taliban’s regime, the hawaladars were the only active and reliable financial actors, offering financial and non-financial services to local, regional, and international clients.\footnote{128} As a result, foreign and local aid agencies found themselves using the Hawala system in order to transfer sums ranging from USD $100,000 to $1,000,000.\footnote{129} In fact, “[n]early all nongovernmental organizations, aid donors, and development agencies used the Hawala system to deliver humanitarian relief and developmental aid to Afghanistan and to move funds around the country.”\footnote{130} The organizations found there was no limit to how much the hawaladars of Kabul were capable of transferring.\footnote{131} Furthermore, transfer fees averaged from 1–2\%, and most transfers were completed in twenty-four hours.\footnote{132}
C. Services

Another very important use that IFTS provide is the ability for individuals or families to pay for services overseas. This can range from something as trivial as travel expenses to something as important as college tuition or medical bills.\(^\text{133}\) Especially in emergency medical situations, immigrant populations find IFTS extremely helpful in quickly sending money back to relatives or elderly parents.

D. Illegitimate Uses

The use of IFTS among smugglers, terrorists, and other black market operations has been widely covered.\(^\text{134}\) As discussed previously, the informal systems can easily be used for capital flight and customs evasions.\(^\text{135}\) More pertinent to current events is that IFTS give terrorist organizations the ability to transfer money under the radars of various federal and international agencies.\(^\text{136}\) Furthermore, many IFTS in post-conflict regions exhibit exploitative tendencies, because they are the only financial options available in a particular area.\(^\text{137}\) Lack of access to records and ambiguous settlement procedures allow for IFTS to be vulnerable to abuse by those in control.\(^\text{138}\) In Afghanistan, for example, the hawaladars are not required to open their books for inspection or auditing under Afghani law.\(^\text{139}\) This makes it very difficult to trace transactions ending with or stemming from terrorist organizations or exploitive hawaladars.

\(^\text{133}\) Joint IMF-World Bank Paper, supra note 14, at 12.
\(^\text{134}\) See infra note 136.
\(^\text{135}\) See supra Part III.I.
\(^\text{136}\) To avoid repetition and to stay focused on IFTS’ remittance implications, please see one of the many publications available for detailed discussions on the darker side of IFTS. See, e.g., Jost & Sandhu, supra note 13; Alan Lambert, Underground Banking and Financing of Terrorism, 15 Fla. J. Int’l L. 9 (2002); Walter Perkel, Note, Money Laundering and Terrorism: Informal Value Transfer Systems, 41 Am. Crim. L. Rev. 183 (2004).
\(^\text{138}\) Maimbo, supra note 121, at 52.
\(^\text{139}\) Id. at 58.
V. COMPETING IN THE REMITTANCE MARKET

Understanding and learning from the success of IFTS provides the formal banking regime with the key to simultaneously unlock the lucrative remittance market and to gain further financial access to various underserved communities. Although remittance transactions may seem small and unremarkable at first glance, “[w]orldwide annual remittances amount to more than one hundred billion dollars,” sent either from an industrialized nation to a developing one or within developing or conflict regions. With such continuous growth in the international and domestic remittance markets, it is important for formal banking institutions to understand why IFTS dominate certain markets, and to use these lessons to improve the formal remittance transfer system and financial infrastructure in challenging areas.

A. The Remittance Market

The impact of the remittance market will not diminish with time as global migration flows continue to expand and grow. In fact, total remittance flows continue to increase and have doubled in a period of less than ten years. Remittances have a significant impact on the receiving country, particularly those with a large diaspora population abroad. The country of Guyana, for example, has a population of approximately 700,000, but the Guyanese diaspora numbers over half a million, allowing remittances to comprise at least 10% of Guyana’s GDP. Small countries are not the sole beneficiaries of remittances. India, even as a rapidly rising global power, is the world’s largest remittance recipient. Indian remittance transactions represent roughly 73% of remittance flows to South Asia and 15% worldwide. In Central and Latin America, Mexico dominates with 34% of the remittances to the region and 8% worldwide, and in Southeast Asia, the Philippines takes in 43% for the region and 8% worldwide.

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141 Id.
142 Id. at 3.
143 Id.
144 Id. at 3 tbl.1.
145 Id.
The flow of remittances impacts not only the receiving country but also the country in which the immigrants now reside. Global migration flows indicate that both unskilled, or “high-volume,” and skilled, or “high-value,” workers emigrate. While the prevailing stereotype suggests that unskilled migrants send money back home to relatives, the “[growing] movement of highly skilled, highly trained professionals” leads to the logical conclusion that remittance rates will continue to rise exponentially, because these immigrants will have access to significantly more disposable income.

Finally, remittance flow impacts the domestic finances and policies of a state, especially states with significant population movement from rural to urban areas, and states experiencing civil unrest, political violence, natural disasters, or war.

There is, however, often a discrepancy between what the IMF or World Bank estimate, and what central state banks estimate with regard to the flow of remittances into a given country. For example, the World Bank reported in 2002 roughly $2 billion in remittances to the Philippines, whereas the Philippines’ central bank reported over $6 billion. This discrepancy is further exacerbated by the fact that central banks often significantly under-report informal funds transfers, and because remittances conducted via direct deposit do not register as remittance transactions.

It is extremely important to remember that the sending of money back to one’s country of origin—to parents, family, or friends—is often simply a cultural characteristic of many immigrant families, and not necessarily about the money itself.

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146 Orozco, supra note 140, at 1. Examples of unskilled, high-volume immigrants are those who work in the textile industry or manual labor. Examples of skilled, high-value immigrants are those who work as scientists, doctors, and academics.

147 Id.

148 See id. at 5, 11–12.

149 See Nakhasi, supra note 62, at 487.

150 Orozco, supra note 140, at 1. Keep in mind, any data collected on the remittance market is an incomplete estimate because official figures are hard to determine when IFTS are the primary means of conducting transactions. Id.

151 Id. at 3.

152 For example, as done in this author’s family, in the Indian culture the giving of money to one’s elders (specifically one’s parents) is viewed as an expected gesture of respect, and typically has nothing to do with the recipient’s financial status.
B. Difficulties of Formal Remittances

Most international remittance transfers occur through licensed regional or international businesses. Western Union is the largest example of such a company. Domestic remittances, frequently evidenced by migrant workers in urban cities sending money home to their families in rural villages, often can be sent via the post office. However, all of these formal options, including banks, face the same obstacles, namely cost and accessibility.

In a recent study by the Centre for Micro Finance at the Institute for Financial Management Research and the Reserve Bank of India’s College for Agricultural Banking, 274 domestic migrant workers and their families were interviewed on how they conducted their personal banking. The intent of the study was to understand how various remittance channels were utilized in India. More than half of the respondents (57%) indicated that they used IFTS to transfer money back to their families. Only 13% of the workers used the Indian Post to transfer funds, and 30% used the banks to transfer funds. The Post was found to be the most costly option: 5% of the total transfer fee, plus another 1% in bribes, not to mention indirect costs. Meanwhile, banks’ average fee was 3% of the total transfer, but respondents cited lack of accessibility as the primary disadvantage for banks. The banks were either too difficult to reach, required too many documents to open an account, or involved too long of a wait. Total time to make a transaction through the bank, meaning travel and wait time, was 2.5 hours on average. IFTS, on the other hand, averaged a 4.6% transfer fee, including incidental costs such as bribes or travel costs, but an average wait time of only forty-eight minutes.

153 Orozco, supra note 140, at 6.
154 Id.
155 See id.
157 Id.
158 Id. Even though Hundi is illegal in India, cash couriers are not. Underground Hundi, however, still flourishes. See supra Part I.B.3.
159 Oliver & Radcliffe, supra note 156.
160 Id.
161 Id.
162 Id.
163 Id.
More often than not, poor domestic or international migrant workers are excluded from the formal payment system because it is unsatisfactory and expensive. As a result they must depend on IFTS. The IFTS succeed where formal institutions cannot for the reasons discussed below.

C. IFTS’ Operational Characteristics

The formal international banking system has much to learn from the success of IFTS like Hawala. Of particular note are the operational characteristics that make IFTS so effective in regions where formal banking has failed. These operational characteristics reflect the concerns of the participant customers and, unlike the formal system, work to alleviate many of these problems.

1. Efficiency and Speed

One of the primary concerns of parties trying to conduct a remittance transaction is the speed with which the money will arrive. As mentioned previously, remittances are often used to provide emergency services or pay bills for relatives in another country. Between major international cities, the average informal funds transfer takes between six and twelve hours.\(^{164}\) When the informal funds exchange is between countries in different time zones or with different languages,\(^{165}\) the transaction can occur within twenty-four to forty-eight hours; however, if the remittance is being sent to an extremely rural area, an area with limited telecommunication technology, or a village without a local hawaladar’s office, the transaction can take slightly longer.\(^{166}\) In contrast, a typical formal transaction through a bank can take up to a week.\(^{167}\)

The informal funds transfer is also not hampered by state government and international regulation requirements that exist in many countries throughout South Asia, Europe, and the United States.\(^{168}\) As is to be expected, the bureaucracy of the formal sector slows any transaction, both financial and non-financial, to a rate that makes it unable to compete with the informal sector.\(^{169}\)

\(^{164}\) JOINT IMF-WORLD BANK PAPER, supra note 14, at 7.
\(^{165}\) Id.
\(^{166}\) Id.
\(^{167}\) Nakhasi, supra note 62, at 484.
\(^{168}\) Id. at 484–85.
\(^{169}\) Id. at 485.
The ideal time frames discussed above are still better than what the formal sector is actually able to provide.\textsuperscript{170} In countries with little to no financial infrastructure—often due to conflict—banks simply cannot operate or conduct any type of transaction.\textsuperscript{171} Afghanistan provides a clear illustration of the IFTS’ resilience when compared to formal institutions: due to the prolonged conflict in that country, the banking infrastructure has been significantly damaged, but an informal transfer to Kabul from a major foreign city will only take from six to twelve hours, and one from Kabul to regional centers within Afghanistan will take under twenty-four hours.\textsuperscript{172}

2. \textit{Accessibility and Adaptability}

Accessibility and adaptability are two characteristics that operate in tandem, because IFTS’ customers come from a plethora of nations, many of which might be suffering from endemic conflict, financial troubles, or growing industrialization.\textsuperscript{173} Often there is a complete lack of faith in the formal banking system of the country of origin.\textsuperscript{174} Also, many of these banks lack the capacity or infrastructure needed to conduct international or domestic remittances.\textsuperscript{175} Unlike formal banks, IFTS can operate in very unstable conditions, because the core of an informal funds transfer simply relies on the ability of two individuals to communicate with each other by any means necessary.\textsuperscript{176} This flexibility is also crucial on a more individual basis, as it can allow participants who are perhaps illiterate, or do not speak the language, to send money to their country or city of origin without having to open a bank account or write a check.\textsuperscript{177}

This adaptability is helpful not only for countries suffering from conflict but also for those suffering from an economic crisis or a natural disaster.\textsuperscript{178} For example, after the 2005 earthquake in Kashmir, Pakistan’s foreign exchange liquidity was so badly debilitated that even the large influx of humanitarian aid and remittances did not meet the foreign exchange

\footnotesize{\textsuperscript{170} See generally Maimbo, supra note 62 (offering a detailed study of the Hawala system in Afghanistan).
\textsuperscript{171} Id. at 1.
\textsuperscript{172} Id. at 5.
\textsuperscript{173} See Nakhasi, supra note 62, at 487.
\textsuperscript{174} Maimbo, supra note 62, at 1.
\textsuperscript{175} Id.
\textsuperscript{176} Nakhasi, supra note 62, at 487.
\textsuperscript{177} Pathak, supra note 35, at 2015.
\textsuperscript{178} Nakhasi, supra note 62, at 487.}
requirements needed by the formal sector. As a result, IFTS became a necessary avenue through which aid could flow, because banks were essentially stonewalling the desperately needed funds. Haiti is another example of this problem: an IFTS could have been a method of acquiring funds in Haiti during the post-earthquake aftermath. Haitian banks did not open until January 23rd, 2010, nearly ten days after the earthquake hit, and the existing payment structure was left in shambles by the disaster.

3. Affordability

The cost of conducting transactions is another customer concern that IFTS can alleviate, but the formal sector cannot. The average cost of transferring funds through an IFTS, between major international cities, ranges between 2–5% of the value being transferred. This fee range is based on the relationship between the parties, the destination, the currency, the amount being transferred, and the negotiating skills of the parties involved. Because many hawaladars operate other businesses that require money transfers—such as import/export exchanges, jewelry shops, ethnic grocery stores, and travel agencies—they already have the mechanisms in place to conduct remittance transactions. In fact, a hawaladar can conduct business right from his or her home. All that is needed is a telecommunication device: a phone, fax machine, or computer with internet access. This simple infrastructure creates very low overhead as compared to the formal system, further bringing down transactional costs for customers.

179 Id. at 487–88.
180 Id. at 487.
183 Maimbo, supra note 62, at 5.
184 See id.; JOINT IMF-WORLD BANK PAPER, supra note 14, at 7.
185 See Maimbo, supra note 62, at 5; JOINT IMF-WORLD BANK PAPER, supra note 14, at 7–8.
187 JOINT IMF-WORLD BANK PAPER, supra note 14, at 8.
188 Id.
4. Anonymity

Virtually all IFTS have very little in the way of standard documentary procedures or accounting requirements, and thus ensure some degree of anonymity. IFTS do not require much paperwork, if any, to start or open an account. There is no minimum balance or minimum transfer amount. This is an especially important feature for low-income workers trying to send money home, and for low-income families trying to receive that money. Furthermore, it is very rare for a hawaladar to keep records of individual or retail transactions; rather, they will keep track of the wholesale transactions mentioned earlier. Remittance transactions, if ever recorded, are often written in code, in very ambiguous or general terms, or in such inconsequential amounts that the average observer would not even notice the transaction. One can equate this to note-taking in a class. Most individuals have their own system of taking notes, and often another person trying to decipher those notes can find the task virtually impossible. As discussed earlier, the only customer identification that is required in most informal funds transfers is the code transmitted to the beneficiary. Even this code, along with any other identifying documents, is usually destroyed upon the completion of the transaction.

The most important aspect of anonymity in informal funds transfers is the fact that formal identification is not required. This factor might be difficult for some to understand, but in many cultures, the communities do not feel protected by the state. In the past, merchants in the Middle East and Africa rarely felt protected by the state, because unlike their European counterparts, the states lacked a “protectionist” attitude towards the middle class and communities from different tribes or clans. IFTS fill the needs of the community in a way that the formal system cannot. For example, “[i]n the post-September 11, 2001 world, typical users of the [IFTS], [especially] those of Middle Eastern ... descent, already are highly sensitized to the heightened government scrutiny” and intrusion of privacy.
such, “[t]hose users are unlikely to prefer a system replete with records and paper trails [and] even legitimate customers ... may desire anonymity and hesitate to draw unwanted attention to themselves or their families overseas.” The cultural idiosyncrasies of a community play a significant role in the remittance market and IFTS as a whole.

5. Cultural Context and Sensitivity

Sensitivity to various cultures and adaptability to local community needs is a key operational characteristic that puts IFTS far ahead of the formal banking institutions, both in the remittance market and in accessing the poor and underserved. The concept of sending remittances is one born of both necessity and tradition, but not all diaspora communities or domestic migrants can afford the time, energy, and money required to send funds or services through formal channels. In illiterate or poorly educated migrant communities, a friendly, local hawaladar is a far more appealing individual to entrust with the handling of hard-earned funds than a faceless bank. This cultural sensitivity factors in at the originating and receiving ends of the transaction. For example, in Somalia, money transmitters usually recruit agents through clan connections. Middle Eastern communities, on the other hand, are the most popular example with regard to IFTS’ cultural context. In very conservative diaspora communities with more restrictive traditions, a trusted hawaladar who respects or understands the social mores of the community would be viewed as an “acceptable intermediary” with whom to conduct business.

6. Trust through Relational Contracts

Though many of these operational characteristics that make IFTS so successful cannot realistically be implemented by the formal system to improve competitiveness in the remittance market, there is at least an overarching lesson to be gleaned from IFTS: trust through relational contracts. All of the operational characteristics rely on an innate semblance of trust with the broker and within the IFTS community. Because of this

199 Id.
201 Id.
202 Id.
203 Id.
204 Lindley, supra note 85, at 525.
206 Nakhasi, supra note 62, at 485.
social element within the IFTS, there is very rarely fraud or a failure to
transfer funds, unlike with commercial options such as Western Union.\textsuperscript{207} Hawala’s high rate of success and reliability is accomplished by creating
incentives to perform and minimizing risks and costs.\textsuperscript{208}

International transfers—whether of goods, services, or money—are
extremely risky.\textsuperscript{209} The moment a client hands over the money, he is ex-
posed to the risk of being held up by a hawaladar, who faces virtually no
consequences in an unregulated system.\textsuperscript{210} IFTS, however, are able to
establish internal legal safeguards ensuring completion of the transaction,
because the system breaks the risky transactions into palatable bite-size
pieces, “break[ing] down a direct transaction between ... parties that would
be encumbered by prohibitively high transaction costs and risks into a
series of [smaller] transactions.”\textsuperscript{211} This reduces risk and promotes per-
formance.\textsuperscript{212} IFTS turn the risky exchange into a “self-fulfillin-
g contract[]” by requiring personal investment,\textsuperscript{213} thus making it a reliable
transaction.\textsuperscript{214} The extent of a hawaladar’s clientele depends on his reputa-
tion with the surrounding community; failure to comply will result in
expulsion from the hawaladar network and “blacklisting.”\textsuperscript{215} As a result,
with every informal transaction there is a personal interest at stake for all
parties involved, especially for the broker.\textsuperscript{216} This investment is the hawa-
ladar’s social capital, which in turn helps build his reputation.\textsuperscript{217} A vested
interest born of concern for reputation cultivates an emphasis on long-term
relationships rather than opportunistic ones, which further limits risk and
promotes performance.\textsuperscript{218}

The IFTS’ ability to induce such an investment without formal regula-
tions has been explained using the economic clubs theory, which discusses
the bridge between private and public goods.\textsuperscript{219} Specifically, “a club is a

\begin{footnotesize}
\textsuperscript{207} Id.
\textsuperscript{208} Id.
\textsuperscript{209} Schramm & Taube, \textit{supra} note 22, at 407.
\textsuperscript{210} Id. at 415.
\textsuperscript{211} Id. at 410.
\textsuperscript{212} Id.
\textsuperscript{213} Id. at 417.
\textsuperscript{214} See Maimbo, \textit{supra} note 62, at 5.
\textsuperscript{215} Id.
\textsuperscript{216} Beyond social capital, substantial start-up capital is required in order to establish
one’s own remittance network. This is why most enter the remittance business after
having built up capital through prior business activities, such as operating a jewelry store.
Lindley, \textit{supra} note 85, at 523.
\textsuperscript{217} Schramm & Taube, \textit{supra} note 22, at 412.
\textsuperscript{218} Id. at 410.
\textsuperscript{219} Id. at 411.
\end{footnotesize}
voluntary group of people gaining mutual benefits from sharing either production costs, special members’ characteristics, or a good that can be characterized by excludable benefits.” Based on this definition, IFTS sound like fairly typical clubs. By creating shared benefits, also known as public goods, IFTS are able to overcome the opportunism that often plagues high-risk transactions such as international monetary transfers. Establishing and preserving one’s reputation within the club, which is needed for success, can be viewed as an investment of social capital. This capital becomes a public good because the existence of the informal funds transfer “club” relies on the characteristics of the investments placed into it. Simply being a member of an IFTS, which occurs upon making an initial investment, does not result in any payoff; rather, a member must continue to make as many investments as possible, which in this case would be the financial transactions.

Finally, customary or unwritten law also acts as a means of enforcement to further strengthen the emphasis on trust, community, and social capital across networks. This was especially evident in Somalia, where agents were dealing with agents from other clans.

VI. IMPROVING ACCESS TO FINANCE BY APPLYING IFTS’ CHARACTERISTICS TO FORMAL BANKING INSTITUTIONS

This analysis of IFTS across the globe matters to the formal banking institution because it offers clues on how to compete in the remittance and previously inaccessible markets. IFTS are able to succeed in unstable and dangerous environments despite their lack of a formal institutional capacity or state-based foundation. Indeed, “[b]anks have realized that the pool of remittance money leaving [countries such as] the United States for Latin America and the rest of the world is not negligible.” This trend is likely to become more prevalent as globalization and the movement of groups of people continue. In 2005, remittance flows from the United States were estimated at roughly $167 million, an increase of $7 million in
less than a year. Put simply, this is a worldwide, multi-billion dollar industry that encompasses household income, global corporations, and local enterprises.

At the same time, providing access to the underserved and the poor should be integrated into any financial agenda, regardless of whether IFTS exist in the targeted market. In Pakistan alone, 50% of the population lacks access to formal or informal financial systems; about 30% have access to informal systems; and 14.3% have access to the formal financial system. This disparity is especially disturbing, because although rural areas are the most underserved and the least financially literate, the same regions often show the most interest in, and are the hungriest for, access to financial services.

By applying key operational characteristics found in IFTS—namely efficiency and accessibility, adaptability, integration, and cultural flexibility—formal institutions can improve their approach to the remittance market, and in turn allow access to formal financial services to be expanded to the poor and underserved. Affordability of services is dependent on the success and presence of the other operational characteristics present in IFTS. By adopting IFTS-inspired techniques, formal institutions could in turn become a more affordable option for vast segments of the population. Promoting mobile banking programs, implementing adaptable banking procedures, integrating IFTS into the formal system, and including cultural considerations in banking strategies are possible tools inspired by the informal networks. Applying these Hawala-inspired techniques will help formal banks maximize the positive effects of remittances for recipients, communities, and countries/cities of origin, all the while improving access to the underserved and poor.

A. Efficiency and Accessibility: Mobile Banking

In 2005, cellular phones became the first communication device to have more users in poor countries than in wealthy ones, and in 2010 cell

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231 Lindley, supra note 85, at 538.
232 See BRINGING FINANCE TO PAKISTAN’S POOR, supra note 137, at 19.
233 Id.
234 Id.
235 See infra Part VI.A–D.
236 Lindley, supra note 85, at 519–20.
phone owners in poor and developing countries “accounted for two-thirds of the world’s 4.77 billion phones.”\textsuperscript{237} This is twice the amount of people who have bank accounts in those same countries.\textsuperscript{238} This trend should begin, and has begun, to be recognized by the banking community as a means to provide them with access to individuals in developing and post-conflict regions.\textsuperscript{239} Mobile banking can provide individuals with access to their bank accounts or transferred funds via cell phone.\textsuperscript{240}

For example, with the assistance of the USAID, the Bill & Melinda Gates Foundation started the Haiti Mobile Money Initiative “to encourage mobile operators and banks to launch mobile money services” in Haiti.\textsuperscript{241} Participating mobile operators offered Haitians the ability to store funds, purchase goods, and conduct transactions through their cell phones.\textsuperscript{242} The program was put into place prior to the devastating earthquake of 2010, and it helped provide access to services while the banks remained closed in the aftermath of the quake.\textsuperscript{243}

The Philippines, meanwhile, has installed a nationwide mobile banking program for rural banks as a means of tapping into the informal funds transfer market.\textsuperscript{244} By seeking innovative and new methods of access, formal institutions can “reach low-income clients who were previously uneconomical to serve,” as well as other participants in the remittance market.\textsuperscript{245} By encompassing IFTS’ key operational characteristic of accessibility, mobile banking could prove to be an economical solution for formal banking.\textsuperscript{246}

\textsuperscript{238} Id.
\textsuperscript{239} Id.
\textsuperscript{240} Id.
\textsuperscript{242} Id.
\textsuperscript{243} Id.
\textsuperscript{245} Pickens, \textit{supra} note 237.
\textsuperscript{246} Id.
B. Adaptability: Financial Procedures and Services

One of the primary challenges formal institutions face in trying to access the remittance market and/or trying to provide access to the poor is the lack of stable financial infrastructures in many of the countries with the greatest need.\textsuperscript{247} This is especially evident in conflict or post-conflict regions.\textsuperscript{248} At the same time, a functioning financial sector is crucial to promoting growth and reducing poverty, both of which are paramount to a populace’s economic and social recovery,\textsuperscript{249} even if said financial sector is dominated by an IFTS. IFTS’ adaptability is critical to their success. Formal institutions can learn from this operational characteristic by switching the focus of financial reform in post-conflict regions from “the brick and mortar of institutions” to “financial products and services.”\textsuperscript{250} This means providing the people with legitimate and practical financial resources, and not just focusing on building the financial infrastructures from scratch. Formal institutions should not focus on what a country does not have, but should focus on working with what a country already possesses. For example:

- if the country has “established social norms and practices [to] determine an individual’s financial standing,” then this should suffice in place of a formal credit registry;\textsuperscript{251}
- if the country has non-collateralized lending practices that survived the conflict, then it is not necessary to focus energy on immediately creating “an active property registry to facilitate collateral based lending;”\textsuperscript{252}
- if the country has a “national network of intermediaries that facilitate the clearance of bills of exchange,” then construction of a national payment system can wait;\textsuperscript{253} and

\textsuperscript{247} Maimbo, supra note 230, at 26.
\textsuperscript{248} Id.
\textsuperscript{249} Id.
\textsuperscript{250} Id. at 27.
\textsuperscript{251} Id.
\textsuperscript{252} Id. at 27–28.
\textsuperscript{253} Maimbo, supra note 230, at 28.
• if the country has codes of conduct enforced by member associations or traditional systems of justice, then a prudential legal framework can be eventually incorporated through the established code at a later date when other crucial priorities have been met.\textsuperscript{254}

If the formal banking institutions initially relaxed some of their requirements, then it is more likely that the poor and underserved of these regions will want to open an account and use the bank’s services.\textsuperscript{255}

Unfortunately, many institutions venture into developing or post-conflict regions with mandatory requirements for borrowing, transferring, or opening an account.\textsuperscript{256} This is an instant turn-off for many of the underprivileged, because when “[u]sing access to credit as a benchmark, the perception of borrowers is that the informal sector operates with much lower service requirements.”\textsuperscript{257} Going back to the idea of relational contracts, IFTS are more willing to enter into these transactions on the basis of “social contracts.”\textsuperscript{258} Requiring credit references, a credit history, and documentation from individuals surviving a devastating conflict is both unrealistic and highly insensitive to those survivors’ plight. In effect, the banks are putting the survivors in a position where they have to resort to potentially exploitative IFTS. By working with the financial building blocks or structures already in place—even if they are old, tattered, or bullet-ridden—tools for financial access can be established more quickly, thus providing access to financial services for those who truly need it.

\textbf{C. Broad Integration}

Outlawing IFTS is not the solution for ensuring the success of the formal banking regime in the remittance market or for increasing access to financial instruments for the underserved, because “[t]he semi-criminalization of small-scale money transmissions rebounds negatively on immigrant communities for whom these systems offer the most ... affordable and reliable way to send money home.”\textsuperscript{259} Rather, success for both the banking world and the underserved communities could be jointly accomplished by broadly integrating the IFTS into the formal economy.

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{254}] Id.
\item[\textsuperscript{255}] Id. at 26.
\item[\textsuperscript{256}] Id.
\item[\textsuperscript{257}] Brining Finance to Pakistan’s Poor, supra note 137, at 31.
\item[\textsuperscript{258}] Id.
\item[\textsuperscript{259}] Lindley, supra note 85, at 531.
\end{enumerate}
\end{footnotesize}
Somalia serves as an example, showing that IFTS can help a relatively prosperous economy exist in a failing, anarchic state. Essentially, IFTS can act as micro-financing institutions. Instead of operating solely outside the realm of banks, the IFTS can be given “access to national and regional payments systems and electronic retail facilities [that] will go a long way toward meeting the requirements of the retail and business sector in terms of banking facilities.”

Not only does this promote development in regions with little to no banking infrastructure, it also provides access to those communities that desperately need various forms of financial services.

The caveat is that this can prove to be extremely difficult. In addition to the deep-seated issues of trust that many communities face when confronted with formal institutions, trying to integrate a culturally embedded practice into what is often deemed a western financial model can be viewed as a paternalistic attempt to usurp a centuries-old tradition.

D. Shift in Banking Culture

In order for formal financial institutions to succeed in capitalizing on the benefits of migrating populations and their disposable income, banks need to create financial links between the diaspora communities and their countries of origin. If the formal industry wants any chance in competing with IFTS, it must recognize the need for trust through relational contracts with the immigrant diasporas in the communities’ specific cultural context. Relying simply on foreign banks with American branches is not the solution to gaining access to the diaspora communities, as is the current practice in the United States. In fact, American banks have just begun to become involved in remittances within the past twenty years, even though the United States has the largest aggregate immigrant population in the world. This simply results in higher costs for customers, which in turn further drives away the lucrative market. Unfortunately, promoting such a change in the long-established American banking culture could prove to be extremely difficult.

261 *Id.*
262 *Id.*
264 *Id.*
265 *Id.* at 9.
266 *Id.* at 10.
267 *Id.*
CONCLUSION

Because Informal Funds Transfer Systems, or Hawala networks, function successfully across the globe in spite of significant problems that plague formal banking transactions in the very same regions, it is very important to continue to expand research into the various IFTS. Beyond their shadowy reputation, IFTS function as robust financial systems that provide services and financial tools to large immigrant or migrant communities and those left vulnerable by conflict. The distinct operational characteristics of IFTS—efficiency, adaptability, affordability, anonymity, cultural sensitivity, and trust through relational contracts—allow IFTS to fill the needs of communities that the formal banking regime has deemed inaccessible or uneconomical. As a result, the formal banking institutions have limited access to the ever-growing remittance market, a market that is continuing to expand as populations and migration patterns shift both internationally and domestically.

Formal remittance banking is impeded by significant accessibility and cost issues, especially in post-conflict regions. Based on the success of IFTS in seemingly unstable regions, formal banking institutions can compete through the use of innovative financial inclusion techniques. Mobile banking and adaptive banking practices can provide the underserved with the opportunity to have access to formal financial services in a much quicker fashion. Other possible solutions include the broad integration of the IFTS into the formal system, or a cultural shift in the banking community, to encompass more relational contracts. Both of these solutions,

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268 See supra Parts II–III, V.
269 See supra Part IV.
270 See supra Part V.C.
271 See supra Part V.A.
272 See supra Part V.B.
273 See supra Part VI.A.
274 See supra Part VI.B.
275 See supra Part VI.C.
276 See supra Part VI.D.
however, will be difficult to implement. Regardless of these potential difficulties, formal banking institutions can learn lessons from IFTS in their attempt to provide greater access to financial services for the poor and underserved in developing and post-conflict regions, while profiting at the same time from the exponentially expanding remittance market.

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* J.D. Candidate, 2012, College of William & Mary School of Law. B.A. Law & Society; Minor International Studies, 2007, American University. I would like to send my heartfelt thanks to my wonderful parents, Dr. Narayanan & Mrs. Sheela Hariharan, for their high expectations and unwavering support, and to my brother, Girish Hariharan, for his unintended comic relief. I want to thank the *William & Mary Business Law Review* for their hard work in preparing this Note for publication. Finally, I would like to thank my friends and loved ones for tolerating me while I worked through the stress of law school and Note writing.