

# MARINE AFFAIRS POLICY FORUM

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## Beating the Banks: Hawala and its potential links to Marine Piracy

### INTRODUCTION

The provisions of the 2000 United Nations Convention Against Transnational Organized Crime includes commitments by states to create domestic criminal offences prohibiting the participation in criminal groups, corrupt practices, money laundering and similar activities. In pursuit of this mandate, states are also expected to cooperate in extradition as well as the freezing of assets. The convention applies to serious crimes which could include the crime of marine piracy and some of the ancillary activities which support it.

This article is based on research conducted under the Dalhousie Marine Piracy Project, an interdisciplinary two-year project on global marine piracy led by the Marine Affairs Program funded by the TK Foundation, and with in-kind support provided by Dalhousie University. It seeks to examine a possible avenue for prosecuting those involved in piracy operations, more particularly piracy backers, whether they are financiers and/or supporters. The analysis focuses on the use of informal value transfer systems (IVTS) to facilitate the movement of funds to aid piracy operations. In so doing, the article specifically reviews the mechanics of hawala, an IVTS used for transferring money worldwide and recognizes its role in the global financial landscape with particular reference to its Somali network.



### OVERVIEW OF HAWALA

Although its exact origins are unclear, it is generally accepted that hawala was used in South Asia and the Middle East in the early middle ages – it is mentioned as early as the 8<sup>th</sup> century in Islamic jurisprudence texts. As migration became more common

amongst those populations, the need to send and receive money over long distances became apparent. In this way, value transfer networks evolved, expanded and became entrenched in the cultural fabric. Hawala is now a vital and positive influence in countries such as Somalia, Afghanistan and Pakistan, where it is prevalent and has deep cultural roots.

However, hawala lacks regulation, does not adhere to record-keeping standards and allows clients to remain anonymous. This 'open' advantage has been utilized by criminals to fund and launder the proceeds of illegal activities. Even though hawala is under surveillance by international financial regulatory bodies, it remains notoriously difficult to track. This has led to widespread demand for a deeper understanding of hawala operations and, by some parties, a call for its eradication.

While the commonly used definition of hawala as *a money transfer without money movement* is accurate, this phrase also applies to other forms of transfers including formal banks transfers. In the view of established governments, there are two main types of money transfers:

Legal/Legitimate	Illegal/Illegitimate
A system of overseas money transfers using licensed, regulated and supervised financial institutions	A transfer or remittance of money outside the regulated banking system or legal financial channels, considered to be an informal underground banking transaction

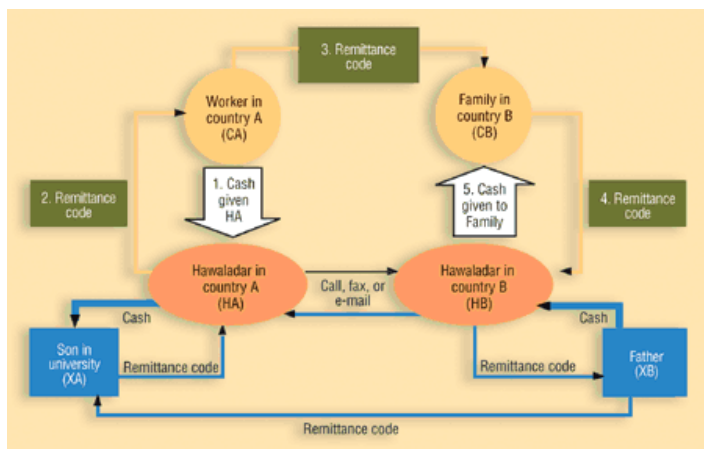
It is open to debate whether in the absence of a secure and uncorrupt financial sector, IVTS should be considered illegal or illegitimate. However, the real differentiating feature of hawala is its reliance on trust as a control mechanism rather than the use of contracts and legal regulation. Hawala networks are based on strong regional, ethnic, or familial relationships and through these shared values, self-regulation becomes possible and, in fact, very effective.

The second defining characteristic of hawala is its informality, where there are no standard practices associated with the transfer of funds, the means of settling debt, or record-keeping. This makes for a network that can easily adapt to changing regulatory, political and business environments. It also makes hawala an attractive channel for unlawful money transfers. However, despite its potential for negative use, hawala's informality should not be confused with illegality, as in a large part, the system is used by honest individuals for legitimate purposes.

Given its deep roots in South Asia and the Middle East, it is foreseeable that IVTS such as hawala continues to survive and its

adherence to Shariah law (*the moral code and religious law of Islam*) adds an even greater appeal for Muslim societies. However, hawala offers benefits that go beyond adherence to cultural norms and fills a major gap in available banking services. As such, much of its success can be attributed to the lack of accessible and affordable financial institutions in the regions where it thrives.

As illustrated below, a basic hawala transfer can be illustrated in a fairly straight-forward way as for example, when a father in country B needs to send money to his son in country A or a worker in country A needs to send money to their family in country B. The transaction is initiated when a customer deposits money with a hawala broker in country A. This broker then contacts another in the recipient country and gives transaction instructions. The promise to settle the debt at a later time is established and, finally, the hawala broker in country B delivers the original deposit amount, less a small brokerage fee, to the intended recipient. No money actually changes hands in this scenario; rather, the broker in country A now has a surplus and the broker in country B now has deficit of cash. In its most simple form, this debt will be balanced when another transfer takes place with funds on this occasion being transferred from country B to country A. The exchange of transaction information can be made via telephone, email, or fax.



**Basic hawala transfer** (Source: Global Development Research Centre <http://www.gdrc.org/icm/hawala.html>)

Hawala transfers are extremely fast, often completed within a single day, mainly due to the lack of a governing regulatory framework and, the extensive range of the networks. Speed is of particular value when funds are being moved into or out of remote areas where, in some cases, it would not only be slow but impossible to send or receive cash. In comparison to formal transfer methods, which can have fees of up to 20%, charges associated with hawala transactions have been found to be as low as 2-4%. Anonymity is yet another of hawala's perks, an obviously attractive feature for criminal users and for those who

lack trust in business and government. Keeping in mind that hawala is most prevalent in countries where infrastructure is lacking and corruption is widespread, a preference for anonymity is easily understood.

## MAJOR FUNCTIONS AND USES OF HAWALA

Remittance is one of the most common uses of hawala particularly where high rates of migration are continuing to occur. It was reported by the World Bank in 2011 that over 215 million migrants worldwide were remitting some \$351 billion, an amount that is three times the size of official development funds. Somalia is a prime example of this phenomenon, where the dissolution of its formal banking system gave rise to many informal money transfer operators to fill the void. In a study published in 2005, it was estimated that up to 70% of the Somali population relies on money received through hawala channels for subsistence, particularly in urban areas.

In the United Kingdom, a 2008 survey of Somali remittance patterns found that 58% of Somalis in that country send remittances home on a monthly basis and 87% do so at least twice a year. Aside from supporting one's family, a common purpose of remittance is for investment in the private sector. This money funds an estimated 80% of startup capital for businesses in the country, where external financing through other means is not an option. In 2012, the US Central Intelligence Agency (CIA) estimated that up to \$1.6 billion is being handled annually by remittance companies, a lucrative business, especially when compared with total imports amounting to \$798 million and total exports only \$300 million. Additionally, United Nations agencies and non-governmental organizations (NGOs) use hawala to transfer emergency and humanitarian funds into countries that lack reliable banking infrastructure. According to estimates from remittances companies themselves, in 2011, over \$1.3 billion of official donations flowed into Somalia, predominantly through hawala networks. Hawala channels play an undeniably vital role in Somalia and while it is reasonable to assume that they are being used for illegal purposes as well, interrupting their operations without careful consideration will likely impose dire consequences on that society.

## GEOGRAPHIC REACH

Hawala networks are extensive and have a global reach mainly due to increasing global migration rates and technological advances in the telecommunications sector.

### *Technological Developments in Somalia and Hawala*

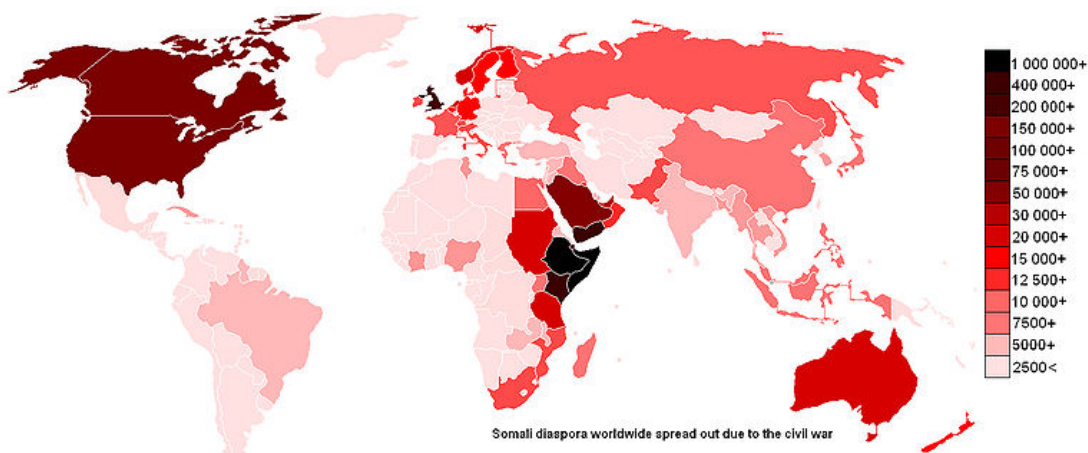
In Somalia, all of the major telecommunications companies offer mobile transfer capabilities. One of these, Somtel, is owned by Dahabshiil, the largest Somali remittance company in operation, and dubs its transfer service 'E-Dahab'. Mobile

transfers are not yet competing with traditional hawala channels for international remittances. However, hawala is also used regularly for transfers within the country's borders. In this market, mobile transfers have moved in as direct competition to traditional hawala channels, offering users safety, speed, and low costs. Of course, whether mobile transfers are more or less susceptible to abuse is debatable.

### *Hawala and the Somali Diaspora*

Based on shared ethnic or regional identity, a hawala network can be spread as far as its diaspora community and, with increased access to the Internet and mobile phones, it is easier than ever to stay connected. Major hawala networks operate out of Afghanistan, Pakistan, and Somalia. For the most part, these networks serve clients of their respective nationalities.

Piracy is an attractive option to many Somalis as it provides significantly higher income than other job opportunities in the country. Although ill-gotten, the proceeds of piracy arguably have some favorable effects in the community, such as job creation, investment capital, and increased indirect spending. A Geopolicity study in 2011 predicted a piracy income increase to \$200-400 million by 2015 under a worst case scenario. Based on Somalia's GDP of roughly \$5.9 billion, that would put piracy proceeds at almost 7% of total GDP. This would be on par with the contribution of industry, which was only 7.4% of the total as of 2008 according to the CIA. It is alleged that members of the Somali diaspora are investing in piracy enterprises through hawala channels, although other reports suggest that there is no evidence of this. Furthermore, estimates suggest that approximately 40-50% of ransom proceeds are moving out of the



**Map of Somali Diaspora** (Source: [http://www.search.com/reference/Somali\\_people](http://www.search.com/reference/Somali_people))

The map above illustrates the Somali diaspora geographically, based on the size of the population. Darker colours indicate larger Somali populations and lighter colours indicate smaller populations. This image shows that Somalis are represented on all continents, extensively so in North America, Australia, Western Europe, North Africa, and the Middle East. This gives Somali remittance companies access to very large economies and the ability to disperse funds across far distances. Agent branches of hawala companies do, in fact, exist in all of the populated areas identified above.

### **POTENTIAL LINKS TO PIRACY**

Given how strongly entrenched hawala is in the Somali society, the question arises as to what role it plays in the funding of Somali piracy and the laundering of its proceeds. Given its lack of infrastructure and governance, it is virtually impossible to obtain definite statistics on any aspect of the Somali economy, let alone statistics regarding its criminal activities. However, some broad points about the relationship can be drawn.

country using hawala, with the rest being reinvested into the business and redistributed within the community.

To this end, pirates and financiers are believed to use hawala to launder ransom money into legitimate businesses or to issue loans to local businessmen. Many academic and policy reports have noted that the Somali Diaspora living in Europe, North America and the Middle East are the main financiers of piracy activity. Because there is limited research that identifies the key piracy financiers and their associated business investments, there is a gaping hole in the counter-piracy approach. Mombasa is often referred to as 'Little Mogadishu' due to the role it plays in money laundering for the pirate gangs and is considered to be a driving factor behind the dramatic rise in real estate in Mombasa.

According to United Nations Office on Drugs and Crime (UNODC), in 2011 pirates made some \$170 million in ransom money for hijacked vessels and their crews, an increase from 2010 ransoms of \$110 million (UNODC, 2012). Therefore, as per the Geopolicity 2011 estimates, if 40% of the



2011 ransom amount moved back through Somali hawala networks, it would account for roughly \$68 million. This amount is undoubtedly high as it is impossible to say what percentage of the ransom money actually enters circulation in the country. However, even funds that end up in neighboring nations are not precluded from movement through hawala, which is primarily due to the network's strong presence in these regions.

Nonetheless, even using the high \$68 million estimate quoted above, piracy revenue would account for only about 6% of the expected annual hawala outflows. These numbers suggest that, although piracy-related money is likely to be moved through hawala channels, these users make up a small percentage of the total client base. As such, it appears that the movement of ransom proceeds is facilitated by, rather than driving, the existence of hawala.



In November 2011, the Royal Netherlands Marechaussee (Constabulary) started participating in a new German-Dutch investigation team set up to focus primarily on identifying the organizers, financiers and negotiators involved in hijacking merchant shipping. It was reported that the investigation team will try to discover where the ransom money goes in an effort to track down the broader piracy network. In this regard, it has often been pointed out that although attacking the pirates' financial system is yet to be proven to be the most effective counter to piracy, pressuring and disrupting the flow of finance to the pirates remains essential.

The growing use of mobile phones for transactions may provide vulnerability in the system. Nevertheless, the opaque nature of the hawala system, its dominance in Somalia, and elsewhere where similar transaction systems are used, and the small percentage of money transactions relating to piracy, will provide a significant challenge to money tracing unless the system becomes more regulated and transparent. That appears unlikely at this stage.

To add to the challenge, in the case of Somalia, the 2012 Transitional Federal Government Audit Investigative Report highlights many irregularities in the management of Somalia's finances. Another recent report indicates that Somalia is

an economy without a state, is the most corrupt country in the world, and has no effective national financial regulatory institutions and essentially no formal banking system. It further highlights that the Somali economy operates through a mixture of licit trade and revenue extraction from illicit financial flows, including public corruption, piracy, arms and human trafficking, and trade-based money laundering, especially in the export of charcoal and livestock and the import of basic foodstuffs and consumer goods. Identification of finance flows offers an opportunity to localize key members of the business model and their trusted connections, and then to act against them. This potential vulnerability needs to continue to be exploited, despite the considerable challenges that it faces, particularly where corruption is also rife.

## CONCLUSION

The issues surrounding hawala are extremely complex. While hawala channels are known to play a role in the movement of illicit funds, and have the capacity to move even greater amounts, that is only one aspect of the business. In many countries, hawala or IVTS is a mainstay of society and cannot simply be shut down without significant negative consequences. It fills a gap left by formal banking institutions and gives people access to financial services from which they would otherwise be excluded. In fact, it is often the only reliable option for money transfers in countries, such as Somalia, that lack infrastructure and has extreme political corruption. This makes hawala channels a lifeline, vital for getting remittances and emergency or humanitarian aid to those that need it. Furthermore, it has deep cultural roots. An attack on the system could be construed as yet another attack on non-Western culture. However, it is also clear that hawala channels are being used for illegal purposes, from evading taxes to facilitating the trafficking of drugs, arms, and humans, as well as piracy in the Horn of Africa.

It is not surprising therefore that hawala is an attractive channel for these groups; it provides anonymity, is unregulated, and does not adhere to record-keeping processes. Though the majority of users are legitimate, the criminal minority is still a significant and likely growing component. In light of this, developing ways to better monitor hawala networks is a valuable pursuit but, in doing so, the multi-faceted nature of the issue must be taken into account. It is clear that hawala use will not decline unless viable alternatives are offered.

This Document is based on research undertaken for the **Dalhousie Marine Piracy Project (DMPP)** by **Jessica MacPhee**. To enhance readability, references are not included but are available upon request at [marine.affairs@dal.ca](mailto:marine.affairs@dal.ca)