INTERNATIONAL JOURNAL OF BUSINESS, SOCIAL SCIENCES & EDUCATION

THE ROLE OF MONEY REMITTANCE COMPANIES ON MONEY LAUNDERING AND CHANNELING MONEY FOR ILLEGAL ACTIVITIES IN KENYA ON THE GROWTH OF FINANCIAL SECTOR IN KENYA

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CITATION: *Mugo G.E. (2015)* The role of money remittance companies on money laundering and channeling money for illegal activities in Kenya on the growth of financial sector in Kenya, *International journal of Economics and Finance (IJEF), volume 1 (2), 78-99. ISSN 2105 6008*

Abstract

Since September 11, 2001, U.S. counter-terror efforts to disrupt al Qaeda's finances have been imprecise at best; at worst, they have had profound negative effects. The question of why hawala poses such a great threat and why there is a need for strict regulation or elimination of hawala has been the subject of great deliberation among policy makers and financial scholars since al Qaeda's attack on New York and Washington, D.C. The purpose of this thesis is to understand the complexities of the hawala informal financial transfer system prevalent in the Middle East and assess its complicity with terrorist financing. To that end, this thesis examines whether the hawala system itself poses a significant terrorist threat to the United States as a medium for financial transactions for terrorist organizations.

By conducting a detailed analysis of hawala in Afghanistan from 2001-2006, this thesis provides a framework to assess whether the hawala system poses a strategic threat in the U.S. led "war on terror." Furthermore, by studying regulation attempts in Afghanistan, this thesis examines the cultural and economic effects of U.S. efforts on Muslims.

Keywords: ***Hawala, terrorism, al Qaeda, war on terror, hawaladar, Afghanistan, informal finance, informal value transfer, Financial Action Task Force***

Introduction

The origin of the term 'money laundering' arises from the practices of the New York Mafia in the 1920s, when laundromats functioned as facades for criminal activities. Mafia groups acquired these launderettes as they gave them a means of giving a legitimate façade or appearance to assets derived from criminal activities. Their proceeds of crime, therefore, were declared to be profits gained through legal activities, that is, launderettes, and were thus 'recycled' or 'laundered'.

As financial institutions have put anti-money laundering (AML) measures into place, the risk of detection has become greater for those seeking to use the global banking system to launder

criminal proceeds. Increasingly, law enforcement see money launderers seeking the advice or services of specialized professionals to help them with their illicit financial operations (FATF, 2004).

Nevertheless, the earliest reported use of the term 'money laundering' in a legal context was in the US in 1982, in the case of *US v $4,225,625.39*4; and it was not until 1986 that money laundering became a criminal offence. The United States was the first country in the world to criminalize ML, through the Money Laundering Control Act 1986. The second country was the UK, through the Drug Trafficking Offences Act 1986 that criminalized the proceeds of drug trafficking activities.

Since the September 11, 2001, terrorist attacks on the United States of America, there has been renewed public interest in informal funds transfer (IFT) systems. Press coverage, which often focused on the putative connection between the informal funds transfer systems and terrorist financing activities, increased the level of official concern about its potential susceptibility to financial abuse. Some national financial regulators began the process of examining existing regulations, and in some cases, designing, developing, and implementing new financial sector policies, including those that address IFT systems. These actions led to a need to better understand the historical context within which IFT systems have evolved; the operational features that make the systems attractive; the fiscal and monetary implications for remitting and recipient countries; and the regulatory and supervisory responses to its current usage.

In 2004, Stephen Schneider published a detailed analysis of legal sector involvement in money laundering cases investigated by the Royal Canadian Mounted Police. This is the only academic study to date which has had access to law enforcement cases and contains a section focussed solely on the legal sector, both in terms of vulnerabilities and laundering methods. His research identified a range of services provided by legal professionals which were attractive to criminals wanting to launder the proceeds of their crime. Some of the services identified include: the purchasing of real estate, the establishment of companies and trusts (whether domestically, in foreign countries or offshore financial centres), and passing funds through the legal professional's client account (Schneider, 2004).

Financial Action Task Force (FATF) typologies have confirmed that criminals in many countries are making use of mechanisms which involve services frequently provided by legal professionals, for the purpose of laundering money FATF (2006) and FATF (2007).

A particular challenge for researching money laundering / terrorist financing methods that may involve legal professionals is that many of the services sought by criminals for the purposes of money laundering are services used every day by clients with legitimate means. There is evidence that some criminals seek to co-opt and knowingly involve legal professionals in their money laundering schemes. Often however the involvement of the legal professional is sought because the services they offer are essential to the specific transaction being undertaken and because legal professionals add respectability to the transaction Schneider, (2004).

Subsequent FATF typologies research mentions the involvement of legal professionals in money laundering/terrorist financing (ML/TF). This research has generally tended to focus more on how the transactions were structured, rather than on the role of the legal professional or his/her awareness of the client's criminal intentions Schneider, (2004).

Organisations representing legal professionals and some academics have sometimes criticized claims that legal professionals are unwittingly involved in money laundering Middleton and Levi, (2004). They have questioned whether it is even possible to identify key warning signs which might justify imposing anti-money laundering/counter financing of terrorism (AML/CFT) requirements on legal professionals and even whether this might be an effective addition to the fight against money laundering and terrorist financing Middleton and Levi, (2004).

Hawala dealers usually charge.25% to 2% Expatriate workers from all around the world: 500,000 Afghans live in the United States where each is estimated to send through hawala $1500 per year, a total of $750 million annually. Dubai DH to Pakistan PKR: Western Union (paid 109.52, received 5,858) Hawala (paid 100, received 5,920) Exchange House (paid 109.52, received 5,901) (Financial Reporting Centre, (2014). The new rules, seen as part of the regulator's effort to curb money laundering, require operators of cash remittance firms to register with CBK and pay a Sh5 million licensing fee in addition to maintaining a minimum core capital

of Sh20 million. Financial sector experts said the rules are targeted at Hawala, a system of money remittance that involves transfer of cash without any records of the parties involved in the transactions. Hawala, which is widely popular in the Middle East and parts of Asia, has been gaining popularity in Kenya, particularly as a money remittance system for residents of Eastleigh Estate in Nairobi who mostly receive money from friends and relatives mainly in Somalia and further across the globe.

Statement of the problem

A drug trafficking example of a complete ML process could be the 'Operation Green Ice'. This was an undercover police investigation, with co-ordinated police raids in Canada, the Cayman Islands, Colombia, Costa Rica, Italy, Spain, the United Kingdom and the United States. At the end of September 1992, the London police discovered a garage in Berdmonsey—southeast of London—with twenty cubic meters of US dollars pounds, guilders and many other currencies, fractioned in small denomination. These came from Colombian cocaine trafficking, derived from the retail sale of the drug all over Europe. The investigation established that the discovered cash money was concealed and ´frozen' in the garage, waiting for the best way to be transferred, moved and finally invested into the legal or formal economy; meanwhile another percentage of these proceeds of drug trafficking, were already converted in financial instruments (e.g., checks or bank notes) and finally, invested in the legal economy. The coordinated investigation resulted in seizures of USD 47.7 million, and the freezing of 140 bank accounts containing USD 7.3 million, and dozens of arrests.

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Objective

The main objective of this study is to find out the role of money remittance companies on money laundering and channeling money for illegal activities in Kenya on the growth of financial sector in Kenya

Literature review

According to Richards, 'Argentina has been identified as one of the world's biggest money laundering countries'. More recently, the FATF's Mutual Evaluation Report on Argentina, underlines that this country 'has not made adequate progress in addressing a number of deficiencies' in their legal framework against ML; so 'the legal and preventive AML/CFT measures that are in place lack effectiveness'.

Secondly, the analysis of ML cases in a developing country such as Argentina makes it easier to explore this subject in other comparable jurisdictions. Basic reasoning is roughly the same across other ML cases perpetrated in comparable jurisdictions. I selected these eight ML cases, since they are the only ones that have substantial and complete court statements in this country. To date no comparative cross-case analysis appears to have been done in this country. Therefore, this analysis is an attempt to fill that gap.

These acquisitive crimes or predicate offences can be performed by one, two or three criminal agents. However, if the acquisitive crimes are a complex criminal activity that requires a highly technical know-how and generate high or substantial amounts of ill-gotten assets, then, the

participation of 'organized crime'throughout the commission of acquisitive crimes could be frequent. In this context, it could be assumed that a criminal agent or a group of two or three criminal agents not organized in organised crime could not easily and effectively perpetrate serious and complex acquisitive crimes and deal with high amounts of the derived proceeds of crime. It is outside the scope of this dissertation to enumerate all the definitions for organized crime.

It could be said that organised crime can and do easily take advantage of the ability to do legal and illegal businesses in any place, instantaneously and under any circumstances. They could take advantage of the facilities of the globalization, sometimes by colluding with other criminal groups or, moreover, by laundering their proceeds of crime on an international or globalize scale. In some contexts, the term 'globalization' is used to refer to economic relations within a single 'world economy'.

In the context of this thesis, I use the term 'globalization' in a broad sense; following Anthony Giddens, to go beyond economics to include any processes that tend to make human relations—economic, political, cultural, communicative, etc— more interdependent.

A second factor is related to the growth of e-commerce systems, technological innovation and the globalization of the economy. Technology, free trade, and consumerism have increasingly brought the world together. Today, individuals, organizations, and governments can move people, goods, services and capital almost as if there were no international borders. Unfortunately, the abrupt technological progress and the internationalization of the economy is connected with the evolution and transborder use of money laundering techniques. The interplay between technology and cross-border finance activities has created unparalleled opportunities for the development of complex and transnational operations of ML. Criminals take advantage of the globalization, for instance, when they move, transfer or submit their accumulated ill-gotten assets through the instantaneous payment systems made over the Internet, which have created and broadened opportunities for criminals and their ML activities. As technology advances, so alas do opportunities for money laundering.

According to O'Leary and von Hippel (2005), "sensible antiterrorism policy targets the relations between insurgents and their constituents." Recent experiences in Northern Ireland and Greece (and now even in parts of Iraq) demonstrate that this strategy works. In April 2005, for example, the sisters of murdered barman Robert McCartney launched a successful and peaceful campaign against violence, which forced Sinn Fein to admit Provisional Irish Republican Army involvement and helped bring the killers to justice. In Greece, the British police worked closely with the Greek authorities to design a public information campaign that contributed to the elimination of the November 17 terrorist organization. Such responses can be symbolically significant and prove to be the "tipping point," encouraging others to counter violence in their communities.

Money laundering and its connection with the financing of terrorism.

The main purpose of this section is to demonstrate whether or not there is a connection or link between the processes of ML and financing of terrorism (FT). I am convinced more and more that the link between ML and FT as it is presented today does not correspond to reality. Indeed, in this section I am demonstrating that it is possible to present the link between both phenomena in a simpler and different way. Considering that we are referring to the term 'financing of terrorism', it seems to be necessary, first of all, to define what we mean by 'act of terrorism' and discuss the main differences and similarities between organized crime and terrorist groups. These preliminary debates are necessary to determine, later, the similarities and differences between ML and FT.

It should be noted that the term 'terrorism' has never been defined in international law. The absence of an internationally agreed upon definition of 'terrorism' poses serious problems for delineating what is 'financing of terrorism'.

However, I overcome this obstacle using the term 'act of terrorism', which was defined in international law. The United Nations Convention for Suppression of the Financing of Terrorism notes that the primary objective of an act of terrorism is to 'intimidate a population, or to compel a government or an international organization to do or abstain from doing any act'. An act of

terrorism includes therefore the deliberate use of violence against civilian targets, with the intention of instilling terror in a population or in a government or an international organization for some political purpose.Like organized crime, terrorist groups could also need to practice money laundering, after generating and accumulating substantial amounts of dirty assets.

Indeed, the so-called War-on-Terror and the expansion of organized criminal enterprises during the last decades have furthered worldwide attention on ML. This arises from the fact that 'trade-based money laundering is used by organized crime groups and, increasingly, by terrorist financiers as well'.

The link or nexus between 'money laundering' and 'money dirtying' operations.

Before analyzing the differences and similarities between ML and MD procedures, it should be said, first of all, that international documents and textbooks in general seem to confuse or misunderstand the process of MD with the process of FT. This is true, for example, on the three-stage theoretical description developed by a book published by the World Bank and the International Monetary Fund (IMF) entitled 'Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism', which tends to describe the techniques of money laundering and financing of terrorism. As a consequence of this confusion on the use of the words 'money dirtying' and 'financing of terrorism', these intergovernmental organizations refer to the 'Three-stages of Money Laundering and Financing of Terrorism'; however, as it will be explained in the following lines, they should have referred to the 'Three-stages of Money Laundering and Money Dirtying'.

Firstly, the World Bank and IMF publication stressed that ML is a process that can be practiced in three different stages (concealment, conversion and integration); and, subsequently, this publication explains that the first two-stages (placement and layering) are common for ML and financing of terrorism processes, whilst the third stage (integration) is different.

Findings

The study found that Profit-maximization is not the main objective of criminals that practice ML in a given country or territory. Instead, criminals that decide to conceal, convert and finally invest their proceeds of crime in the formal economy will expect, as a priority, to finish the laundering process with impunity, that is, without being detected by law enforcement authorities. This assessment is founded on the nature of the laundering process. ML is, in essence, both concealment and investing process. So, following this primary aim, maximization of profits could be a second and less important aim, but not a priority.

The findings also show that U.A.E. has aggressively engaged the *hawala* system in its country with far-reaching effects. With continual anti-money laundering and *hawala* legislation, it has set itself apart as the leading *hawala* regulating country. As a leading financial hub for the Middle East as well as the world, the second and third order effects of its regulations have hampered *hawala* systems throughout the world, but especially in the Middle East. While this thesis doesn't focus on the U.A.E., it provides a snapshot over another perspective on *hawala* regulation. U.A.E. regulation is much more aggressive than in Afghanistan or Pakistan. But, with a robust formal sector, it can afford to be.

Conclusions

It has been the business of this chapter to introduce and analyze the phenomenon of money laundering itself. For that purpose we explained, first of all, the meaning of the term 'money laundering' and, later, we explored how ML operates. Most of the explanation referred to the way ML works derived from assertions made in international documents and textbooks, and supported by a cross-cases analysis of relevant ML cases, which were included in a chart on the Appendix I. Subsequently, we evaluated the link or nexus between ML and the 'financing of terrorism' and, after, we have studied the similarities and differences between the processes of

'money laundering' and 'money dirtying'. Finally, we have also examined some of the key causes and effects of ML. It is against this background that problems confronted by the international legal order against ML must be seen. It is to this issue that this study now turns.

Hawala regulation also appears steep in "mirror imaging." There seems to be a belief that universal regulation, blunt tools such as the PATRIOT ACT, EO 13224, or those offered in the FATF special recommendations are going to ubiquitously act as penicillin for the incongruities and faults of hawala networks throughout the world. This is false and a disastrous cognitive pretext for reform.

Perhaps the most important truth to glean from Afghanistan is the utter inefficacy of any reform that does not include the hawaladars themselves in the creative process. Due to the social constraints, business practices and history of self-regulation, it is imperative to have hawaladar support in any regulatory measures. Less than full endorsement and collaboration in regulatory legislation or enforcement will doom any such measures to failure. Trust must be earned. However, the government can reach out to hawaladars over time, heeding their advice, and slowly nudging them to the formal sector incrementally. Reform must slowly occur in formal financial sectors, but must also include financial education and literacy, and be accompanied by several iterations of corruption-free government. Terrorist-free informal financing in Afghanistan will be a slow, collaborative effort led by the hawaladars as trust is formed with the central government and the legal frameworks of Afghanistan slowly garner legitimacy. It must take place within the context of Afghanistan, though.

It is a mistake to over-regulate hawala, and to the extent that it must be regulated, the greatest cultural deftness must be employed. If the U.S. is to curb Islamic "extremism" and jihadism in its "war on terror" than it absolutely cannot afford to continue offering an olive branch to moderate Muslims even as it wields a blunt and deadly financial hammer in the other hand.

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