

## Dark Banking: the global impact of illicit underground banking systems

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July 2024

**Global underground banking networks like China's Fei Ch'ien, and the Middle East and Africa's Hawala, form an extensive and intricate network of financial channels that trade outside the recognised global banking system.**



**They facilitate the movements of billions of dollars' worth of transfers each year across borders, to serve both legitimate and illicit requirements. In some cases, their services are vital, especially in regions where access to traditional banks is scarce, enabling migrants to transfer funds to their homes and businesses.**

However, the opacity and vast scale of these networks makes them susceptible to exploitation, particularly among criminals. Organised Crime Groups (OCGs) and terrorists alike use these banking methods to launder money, fund operations and evade international sanctions. The nature of such decentralised and trust-based networks prevents global regulatory bodies from monitoring and governing illicit financial flows with any certainty. The dual-purpose aspects of underground banking networks highlight their impact on global finance and crime, revealing a lack of control over their ability to provide an essential service to those in need, and being exploited for nefarious purposes.

### **Understanding illicit underground banking systems**

These banking networks, sometimes referred to as Value Transfer Systems, rely on a network of brokers who manage the transfer of funds based on trust and reciprocity, as opposed to direct money exchange. This permits funds to travel across borders without any physical movement of cash, avoiding standard banking regulatory scrutiny. The secrecy and professional efficiency of these systems is causing significant problems to international law enforcement, as large sums of money exchange hands undetected.

## **Key systems – exploring prominent underground banking networks**

The most prominent underground banking networks and their distinct mechanisms and histories play an important role in the world's financial arena.

*Fei Ch'ien (flying money in Chinese):* Originating from ancient China, is possibly one of the oldest forms of money transfer. It evolved during the Tang dynasty (618-907AD) to enable trade along the historic Silk Road. Fei Ch'ien allowed Chinese expatriates and businesses to move money via trusted agents without moving cash. This resilient and adaptable system continues to thrive, supporting Chinese communities across the globe.

*Hawala (to transfer in Arabic) - aka Saraf:* Also an ancient system rooted in the Islamic world that can be traced back to the 8<sup>th</sup> century and the rise of the Islamic Empire. It was initially created to facilitate trade across the empire from the Middle East to South Asia. The Hawala network of brokers are known as Hawaladars and they settle balances without money, relying on mutual debts between agents. This system is used today notably across the Middle East, Africa and South Asia.

*Hundi:* Not dissimilar to Hawala, Hundi is mostly active in South Asia, in particular India and Pakistan. It is a system that has been used for centuries for regional trade, built on trust, manoeuvring capital without any formal traceable record.

*The Black-Market Peso Exchange (BMPE):* The BMPE is a more modern system compared to its counterparts, used predominantly by drug cartels in Colombia and Mexico to launder narcotics revenue from US dollars to pesos. It first appeared in the late 20<sup>th</sup> century as drug shipments spiked, creating a need for gangs to move vast amounts of US dollars covertly.

*Chop:* Similar to Hundi and Fei Ch'ien, Chop is mostly seen operating in Southeast Asia. It is mainly used by communities with substantial Chinese influence, moving capital across borders discreetly and efficiently.

*Tandas:* Or Rotating Saving and Credit Associations (ROSCAs) are informal financial groups operating in Latin America and Africa. They allow community members to have access to credit and money without the watchful eye of commercial banks.

### **The role of state and non-state actors**

Several states, especially those with tighter currency controls or who are under international sanctions - including Russia, China, North Korea, Venezuela, Iran and Somalia - have been suspected of turning a blind eye to these informal operations. Although this inferred approval allows for money to be transferred unregulated, it must not be forgotten that in some cases, it is a lifeline for those who are indeed victims of terrorism in Africa and the Middle East. It is widely accepted that the disruption of informal banking practices like Hawala, can jeopardise the very survival and protection of innocent people, to include women and children. State involvement does, however, complicate international relations and the policing of money laundering, in particular where used to finance disputed conflicts and terrorism.

### **Impact on global governance and compliance**

Following the terror attacks that occurred on 11 September 2001, there was a US-led global campaign to tighten regulations focused on dismantling all networks that supported terrorism and other criminal activities. The US Patriot Act was one such initiative that looked to increase transparency and improve oversight. Despite these concerted efforts, Hawala is still a key financial platform for the Taliban, Islamic State and al-Shabaab. The decentralised and cross-jurisdictional nature of underground banking networks continues to challenge international law enforcement capabilities. Existing laws, more often than not, fail to keep up with the evolving tactics of the bad actors that exploit these informal practices, highlighting the gap between the good intentions of enforcement bodies, and the on-ground realities of financial governance.

### **Effects on global trade and political relations**

There is no doubt that underground banking networks have a profound impact on global trade and geopolitics, facilitating interactions that go beyond simple transactions. Economically, these systems assist bad actors in performing a range of activities from laundering money to tariff avoidance, therefore producing misleading trade patterns. By enabling the movement of high volumes of money outside of formal banking systems, underground networks erode the power of economic sanctions and trade tariffs imposed by governments, allowing for capital flows to move unseen. This has an effect on global stability and can possibly lead to revenue losses in duties and taxes.

## **Political ramifications**

Politically, the mere presence and tolerance of these banking networks can antagonise international relations, particularly when countries are not only ignoring these networks, but also harbour and protect them. This can lead to penal action like increased sanctions or diminished foreign aid from frustrated nations. In addition, the use of these underground systems by terrorists and OCGs to finance their operations raises significant security concerns, instigating law enforcement collaboration that is fraught with mistrust and difficulty. The ripple effect of these networks on global trade and the political status quo are significant, requiring a reevaluation of cross-border regulation and policing strategy.

## **Case studies**

Underground banking networks have been the target of several high-profile crackdowns of late, demonstrating that they are not infallible.

### *Black Market Peso Exchange (BMPE) scheme raid in the USA in 2014*

In Southern California, the drug task force, High Intensity Drug Trafficking Area (HIDTA), brought down an international money laundering operation linked to a BMPE scheme. It was the first ever BMPE money laundering conviction in California involving actors linked to the Sinaloa Cartel and Colombian money launderers. The investigations led to the seizure of over US\$100mn and narcotics in the state of Los Angeles in September 2014.

### *Hawala Group in Germany seized in 2019*

In November 2019, German agencies raided a suspected Hawala banking network. It was believed that this network was transferring €1mn a day to Turkey, with a total of up to €200mn being moved since inception. Police searched over 60 apartments and offices and interrogated 27 people, which ultimately resulted in 6 arrests. The operation involved 850 surveillance officers working across Germany. This raid followed a year-long operation targeting various businesses, to include jewellers and precious metal traders trading mainly in North Rhine-Westphalia. While this network primarily transferred migrant remittances, the sophisticated nature of the operation raised suspicions as to its ability to launder illicit funds. Underground banking networks like Hawala are illegal under Germany's Payment Services Oversight Act (ZAG), which specifies that it is forbidden to offer services similar to those of a bank without a banking license.

### *Hawala Group in India seized in 2023*

On 19 June 2023, India's Directorate of Enforcement (ED) raided 14 locations in Kerala that were suspected of operating as Hawaladars and illegal forex dealers. Under the Foreign Exchange Management Act, an assorted value of currencies worth approximately Rs1.50crore (US\$180,000) and Indian Rupees worth Rs1.40crore (US\$170,000) were seized. The actors involved were said to be accused of illegally trading currency via Hawala networks to Dubai, the US and Canada, avoiding legal banking regulators.

### **Conclusion**

Despite continued international efforts to combat and dismantle illicit underground banking networks, they remain to thrive with the industry said to be worth billions of US dollars a year. The networks expertly take advantage of gaps in global financial governance, to evade detection and countermeasures. This relentless persistence reveals the unsurmountable challenges faced by law enforcement agencies and the underground financial systems that operate beyond the radar of traditional frameworks. There is a need for enforcement to be innovative, and for all to unite and report instances of financial crime in a bid to curb their influence effectively.

*"Secretive money flows, when they build up, can destabilize the entire financial system."*  
Paul Volcker, former Federal Reserve Chairman.

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