

# Informal fund transfer systems

Citation for published version (APA):

Han, C. R. (2020). *Informal fund transfer systems: mechanisms, survival, and adaptation*. [Doctoral Thesis, Maastricht University]. Maastricht University. <https://doi.org/10.26481/dis.20201207ch>

## Document status and date:

Published: 01/01/2020

## DOI:

[10.26481/dis.20201207ch](https://doi.org/10.26481/dis.20201207ch)

## Document Version:

Publisher's PDF, also known as Version of record

## Please check the document version of this publication:

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## Summary

Most people visit formal financial institutions or use online banking services when they should send funds across borders. However, some people use unauthorized remittance operators, or informal fund transfer systems (IFT-systems), to send remittances to foreign countries. IFT-systems may be an unknown phenomenon to the general public. They may not have a clear idea on how IFT-systems work and whether they are perceived as acceptable and legitimate in society. This study was conducted to examine why and how IFT-systems survive in a globally connected world and how they adapt to changing environments. Before addressing the question, this study first discussed about the legitimacy of IFT-systems in parallel with an illustration of the basic working mechanisms of them. That is because the legitimacy of IFT-systems is associated with the risks — external and internal risks — that IFT-systems face and cope with. While describing the working mechanism of IFT-systems, this study showed that IFT-systems adopt the same mechanisms as formal remittance systems. This study also examined how IFT-systems differ from formal remittance systems, explaining that IFT-systems have two aspects — a channel for cross-border fund transferring and a channel for money laundering. While examining the roles that IFT-systems play in a given society, this study contrasted two approaches: an economic approach and a criminological approach. The two approaches relate to different positions on the legitimacy of IFT-systems: While the economic approach tends to construe IFT-systems as legitimate albeit illegal, the criminological approach seems to view IFT-systems as illegal and unacceptable.

This study employed two research designs and two research methods, in relation to two research sub-questions. A cross-sectional design and data analysis was adopted for the global analysis of IFT-systems to answer the first sub-question: to what extent do IFT-systems (or are they likely to) thrive across countries despite adverse external environments? The global landscape of IFT-businesses — a collection of IFT-risks faced by each country — entails the question of which countries are more — or less — susceptible to adverse environments, or external risks (e.g., an increased control of IFT-

systems, fierce competition with formal remittance channels, and negative societal attitude towards the informality)? The global analysis of IFT-risks is based on several secondary (public domain) datasets from international entities, such as the World Bank and the FATF. These datasets deal with macro-level factors that are likely to be associated with IFT-activities, such as migration, financial inclusion, AML/CFT measures, and societal attitudes towards informality. The global analysis resulted in the development of a global IFT-risk indicator that gauges the level of IFT-risk faced by each country in the form of a composite indicator. A case study design and thematic analysis was used to address the second sub-question — how IFT-transactions are carried out despite the internal risks that IFT-users and IFT-brokers face (e.g., deception and betrayal) — by examining IFT-systems in Korea. The case study on IFT-systems in Korea focused on investigating the adaptation of IFT-systems to the internal risks. This was done by investigating the relationships between the actors involved in IFT-activities in light of trust and risk. The data analyzed for this case study include the IFT-case reports of the Korean customs administration and the interviews with Korean government officials who investigated or had knowledge of IFT-systems. In conducting research on the survival and adaptability of IFT-systems, this study is based on the view that IFT-systems in Korea are exposed to different environments from those in other developing countries. In other words, IFT-systems that survive in — and adapt to — harsh external environments may have salient features that IFT-systems in favorable environments do not have or need.

This study conducted an analysis of IFT-risks from 121 selected countries to provide a panoramic view on the global landscape of IFT-systems. With macro-level factors that are likely to contribute to the survival of IFT-systems, this study a ‘global IFT-risk indicator’ to gauge the degree of survival (or prosperity) of IFT-systems across various countries. Most of the developed countries analyzed were rated as having low IFT-risk, mainly because of a high level of access to formal financial institutions and a high level of compliance with international AML/CFT standards. However, among the developed countries, some countries considered popular destinations for immigrants were rated as having a high level of IFT-risk. On the other hand, most of the developing

countries were rated as being exposed to a high level of IFT-risk because of a large number of emigrants, poor formal financial systems, low compliance levels with international AML/CFT standards, and lenient attitudes towards illegality. The global IFT-risk indicator suggests that the level of IFT-risk is related to the level of economic development of each country.

For the country-focused analysis (the local analysis) of IFT-systems in Korea, three theoretical frameworks — the sociology of (illegal) markets, social exchange theory, and the perspective of trust and risk — were employed to examine the relationships and interactions between the actors in IFT-systems. This is because the focus of the local analysis is on interactions (e.g., trust, risk-taking, and transactions) between the actors in IFT-systems, rather than on the criminality of the actors or on criminogenic opportunities, and the three theoretical frameworks can be applied to IFT-systems that operate in environments where ethnic ties, social embeddedness, and informal social control are weak or restricted. Based on the theoretical frameworks, the local analysis of IFT-systems shed light on the internal dynamics of IFT-systems. This study presented a temporal sequence of IFT-activities consisting of 11 procedures, inspired by Derek Cornish's crime script analysis, and analyzed them, in terms of trust and risk. While the main findings from the local analysis confirmed those of previous studies on IFT-systems, this study produced several new findings on IFT-systems. IFT-users and IFT-brokers actively used online banking services in sending funds to the other party. This somewhat contrasts with the general assumption that IFT-systems are isolated from formal financial institutions, except with regard to the procedure for the settlement of outstanding debts between IFT-brokers. This study identified 'solo IFT-brokers', whose existence contradicts the conventional IFT-systems where separate IFT-brokers in sending and receiving countries work together to transfer funds. Through online banking services, solo IFT-brokers provided IFT-services in both sending and receiving countries without counterpart IFT-brokers. This study found that online banking services also benefit IFT-users. By using these services, remitters can easily send funds to IFT-brokers in remote places, leaving trails that work as a safeguard to protect them from IFT-brokers who fail to meet their obligations. Online banking

systems therefore play an important role in reducing the vulnerability of both IFT-users and IFT-brokers facing social uncertainty. This study also identified some variant IFT-transactions, which differ from the traditional *hawala*-style IFT-transactions. They transfer funds across borders through the wire-transfers of formal financial institutions and the physical transfer of cash.

As for policy recommendations, while critically reviewing existing AML/CFT measures against IFT-systems, this study puts forward not only general considerations for measures against IFT-systems, but also practical measures that would make it possible to take advantage of the external and internal risks that threaten IFT-systems. They are based on the situational crime prevention and behaviorally-informed approaches. While the global IFT-risk indicator may enhance societal capacity to monitor IFT-risks across countries, these policy recommendations may provide the global AML/CFT community with more options in the fight against IFT-systems.