

Hawala Scam in India - A Case Study

Introduction

Hawala can be defined as a money transfer method, which takes place outside the traditional banking system and requires a minimum of two Hawala dealers that take care of the “transaction”. Hawala is used in India, Middle East and South Asia and it is an ancient system of transferring money. The difficulty with these transactions is that they are entirely out of the radar and are unlike the unlawful way of doing business.

How Hawala system works?

An individual who wants to transfer money to another country gets in contact with a Hawala dealer (dealer A). He gives him/her the money plus a commission and the information of the beneficiary of the funds. At this moment, the individual receives a unique code. The dealer contacts (i.e. via phone or fax) a Hawala dealer (dealer B) from the country where he wants to send the money. The dealer B will give the amount of money that the dealer A asked him to give to the designated person, who has to reveal his code in order to prove that it is him/her the receiver of the money.

Hawala dealers: their key role in the system

There is no physical movement of cash. Hawala brokers are the key people in these transactions. The whole system is based on the trust (which is actually what “Hawala” means) between them. They keep an informal

journal to record all their transactions, and they settle their debt in different ways. It is essential to mention that Hawala brokers are neither licensed nor supervised.

Reasons why Hawala transactions exist

The question that arises is why use the Hawala system and not a conventional banking system? Although a traditional banking system seems and probably is a safer way to transfer money, Hawala is used a lot by immigrants who want to send money back to their families or vice versa. It is a popular way to move money because in comparison to the banking system, Hawala is cheaper, faster and less transparent. The Financial Action Task Force (hereafter "FATF") published a [report on Hawala](#), in December 2013. The report refers to the results of a questionnaire answered by individuals in 22 countries and the reasons why Hawala is used according to them. Based on the results, the main reasons for the use of Hawala can be summarised as :

- Cheaper Money Transmission
- Faster Money Transmission
- Cultural Preference
- Lack of banking access in the receiving or sending country
- Higher trust in Hawala system than the banking system
- Avoid Currency Controls
- Avoid Law Enforcement Agencies Tax evasion
- Transfer and mask criminal actions

The nature of these transactions, as revealed by the reasons for the use of Hawala system, have inevitably led to compliance implications.

What are Hawala Business Compliance challenges?

Compliance professionals have to face the danger of Money Laundering and especially [Financing of Terrorism](#) arising from Hawala transactions. The anonymity and the lack of documentation have made Hawala ideal for illegal transactions, which are difficult to trace. This is the reason why Hawala is illegal in a lot of jurisdictions. Hawala dealers may use different techniques to settle their debts to each other. Some of them are the “reverse Hawala” between two Hawala dealers; the multilateral settlement between several Hawaladars who are part of the same network; the settlement through trade transactions, like over-invoicing; the settlement through cash via cash couriers, banking and money services business ("MSB") channels.

Hawala scandal in India

The Hawala scandal, also called the Jain Diaries case or the hawala scam was an [Indian](#) political and financial scandal involving payments allegedly sent by politicians (black money) through four [hawala](#) brokers, namely the Jain brothers. It was a US\$18 million bribery scandal that implicated some of the country's leading politicians.

The case details -

The Jain Hawala story was broken by two Delhi-based journalists Ram Bahadur Rai and Rajesh Joshi, working for the Hindi daily Jansatta. Then Vineet Narain, the journalist filed a public interest litigation in the Supreme court of India.

In 1991, an arrest linked to militants in Kashmir led to a raid on hawala brokers, revealing evidence of large-scale payments to national politicians. On 25 March 1991, as per the court proceedings published by the Supreme court of India, Ashfak Hussain Lone, a person alleged to be an official of the terrorist organisation Hizbul Mujahideen, was arrested in Delhi. During his interrogation, the police learnt that his organisation was funded through hawala, using Surendra Kumar Jain and his family as a conduit. Based on this and further information received during Lone's interrogation, the Central Bureau of Investigation (CBI) conducted raids on the premises of Surrender Kumar Jain, his brothers, relatives and businesses. During the raids, the CBI seized Indian and foreign currency, two diaries and two note books at the premises. These diaries contained detailed accounts of vast payments made to people, identified only by initials, who were high ranking politicians, both in power and out of power, and of high ranking bureaucrats. At this stage, the investigation stopped at the CBI and neither the Jains, nor the contents of their diaries were investigated. Meanwhile, officers of the CBI involved in the investigation were transferred to other places by orders from ruling

politicians. However, the case continued to make headlines in the news media, as it was pursued by a few journalists.

On 4 October 1993, writ petitions were filed in the Supreme court of India, in the public interest under Article 32 of the Constitution of the India. These contained allegations that Government agencies like the CBI and the revenue authorities had failed to perform their duties and legal obligations as they had "failed to investigate matters arising out of the seizure of the "Jain diaries"; that the apprehension of terrorists had led to the discovery of financial support to them by clandestine and illegal means using tainted funds obtained through 'hawala' transactions; that this had also disclosed a nexus between politicians, bureaucrats and criminals, who were recipients of money from unlawful sources, given for unlawful consideration that the CBI and other Government agencies had failed to investigate the matter, take it to its logical conclusion and prosecute all persons who were found to have committed an offence; that this was done with a view to protect the persons involved, who were very influential and powerful; that the matter disclosed a nexus between crime and corruption at high places in public life and it posed a serious threat to the integrity, security and economy of the nation; that probity in public life, the rule of law and the preservation of democracy required that the Government agencies compelled to duly perform their legal obligations and to proceed in accordance with law against every person involved, irrespective of where he was placed in the political hierarchy." In

India, the Hawala method is an illegal method of transacting in foreign currency. It is illegal and contentious due to two reasons. Firstly, it is highly secretive as it does not reveal the identity of people on either side of the transaction, even to the hawala operators. Secondly, it violates the FERA regulations of India as it does not use approved channels of regular banks for foreign currency transactions. However, it is often used in India for two reasons. Firstly, to transfer legally earned salaries (example : by ordinary workers overseas in Saudi Arabia and UAE) to their hometowns, as hawala transaction costs are a fraction of banks, and hawala operators can be found in the smallest villages of India. Secondly, by politicians, bureaucrats and nefarious elements to transfer corruption money.

Discovery of involvement of politicians in hawala

Those accused included L. K. Advani, V. C. Shukla, Devi Lal, Sharad Janata Dal, and Madan Lal Khurana. The list contained politicians from multiple political parties including BJP, INC SJP and Janata Dal and one independent, with amounts varying between Rs. 50,000 to Rs. 7.5 crore. The prosecution that followed was partly prompted by a public interest petition (see Vineet Narain), and yet the court cases of the Hawala scandal eventually all collapsed without convictions. Many were acquitted in 1997 and 1998, partly because the hawala records (including diaries) were judged in court to be inadequate as the main evidence. The CBI's role was criticised. In concluding the Vineet Narain case, the Supreme Court of India directed that

the Central Vigilance Commission should be given a supervisory role over the CBI.

CBI REPORT

Surindra Kumar Jain was arrested based on the complaint made by Vineet Narayan and it was he who revealed the whole story and a formal report of nearly 120 pages was prepared. Vineet Narayan also filed a complaint against the Prime Minister for influencing the enquiry. So the court ordered the CBI not reveal any information regarding the investigations to any higher authorities or political personalities. The court has to be appreciated for this for they passed a strict order to the CBI though they were directly under the control of the Government. Mr. Narsimha Rao, the then Prime Minister of India stubbornly refused to compromise that he or any of his colleagues had ever interfered in the Hawala case. He held that all those who were supposed to be incriminating in the case must be deemed innocent, unless proved otherwise.

The charges to all the chargesheeted politicians are as listed below:

- **Section 120-B Indian Penal Code (IPC):** Being party to or abetting a criminal conspiracy to commit an offence.
- **Section 161 IPC:** Whoever, being or expecting to be a public servant, accepts any gratification, other than legal remuneration, as a motive or reward for showing favours while exercising official functions.

- **Section 165 IPC:** Whoever, being a public servant accepts any valuable without consideration from any person with whom he is likely to have a transaction is liable for punishment.
- **Section 7 Prevention of Corruption Act, 1988 (PCA):** Whoever, being or expecting to be a public servant, accepts any gratification other than legal remuneration, as a motive or reward for showing favours to any person.
- **Section 13(1)(d):** A public servant commits criminal misconduct if he, by corrupt or illegal means, obtains for himself any valuable by abusing his position as a public servant and without showing any public interest.

Supreme Court judgment

The supreme court proceeding did not relate to the hawala case per se, but rather to the suspicious transfer of the CBI Director Joginder Singh and the rampant misuse of political power to curb the investigations of the CBI and Revenue department. In its judgment, delivered on 18 December 1997, the court, through judges S.P. Bharucha and S.C.Sen gave a ruling consisting of a 26 points list of pronouncements, the most important of which made it impossible for politicians in the government to remove the Director of the CBI for 2 years, thus ensuring that the CBI and its officers would have freedom to carry out their work without political interference.

Chinese hawala Scam

The Enforcement Directorate (ED) had registered a case of money laundering against Luo Sang alias Charlie Peng and others in Chinese hawala scam. The financial probe agency's action came days after the Income Tax department on August 11 mounted a search at various premises of identified Chinese entities, their close confederates and couple of bank employees.

The IT department action was followed after credible information with the tax department that a few Chinese individuals and their Indian associates were involved in money laundering and 'hawala' transactions, via a series of shell entities. The search operation revealed that at the behest of Chinese individuals, more than 40 bank accounts were created in various dummy entities entering into credits of more than Rs 1,000 crore over the period.

A Central Board of Direct Taxes (CBDT) statement also said that a subsidiary of a Chinese company and its related concerns have taken over Rs 100 crore bogus advances from shell entities for opening retail showrooms in India.

Incriminating documents linked to hawala transactions and laundering of money with active involvement of bank employees and chartered accountants has been found during the search. Evidence of foreign hawala transactions involving Hong Kong and US dollars have also been unearthed. The tax department is continuing further investigation.

An initial probe by the tax department revealed that Pang was representing many Chinese firms for hawala operations in India. With the help of some employees at Bandhan Bank and ICICI Bank, he was infusing around Rs 3 crore through Hawala daily. It was found that Sang operated over 40 bank accounts, created by various dummy entities, which received advances of thousands of crores from shell companies. Tax officials also raided bank employees and premises of several Chinese companies, suspecting the scam to be well over Rs 1,000 crore.

The scam was unearthed after the I-T Department received credible information that a few Chinese individuals and their Indian associates were involved in money laundering and hawala transactions through a series of shell entities.

A dossier related to the arrest of alleged Chinese hawala trader Luo Sang back in 2018 showed that police had seized an Aadhaar card, a PAN card, and a passport issued in the name of Charlie Peng, his fake Indian identity.

Luo Sang was arrested by Delhi's Special Cell police station two years ago in relation to a Hawala racket but was eventually let off by the court. Other items confiscated from his possession included a passport in the name of one Lalthara Khawlhring, a Toyota Fortuner SUV, and \$2,000, Rs 3,40,000, and 22,000 Thai baht.

In its probe against the Hawala racket run by Chinese entities and their Indian accomplices, the Income Tax (I-T) Department discovered that Sang had assumed the identity of an Indian national, Charlie Peng. He has been allegedly running the racket for the past three years and used to change addresses frequently.

The dossier showed that Sang was originally from Lhasa district in Tibet. Meanwhile, the Aadhaar number had two addresses, one in Delhi's Dwarka and another in Manipur, seeded into it. The passport bore an address in Manipur as well. However, his address at the time of his arrest in 2018 was DLF Phase-5, Gurugram. The probe further revealed that he also married a girl from Manipur.

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involved in money laundering and hawala transactions through a series of shell entities.

FEMA Act-

Article 3 of the FEMA Act, 1999 states that no person shall—

- (a) deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;
- (b) make any payment to or for the credit of any person resident outside India in any manner; (c) receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner;
- (c) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

As the Hawala dealers do not comply with the above article, the transactions carried out by them are illegal.

Conclusion

Hawala is an existing parallel illegal exchange market. Hawala mode is used by exchanging currencies without the involvement of the central bank. Individuals who require a higher exchange rate, do not have access to bank accounts, receiving kickbacks (illegal) use Hawala transactions. FEMA act only allows exchange of foreign currencies by authorized dealers and so Hawala transactions are illegal within the FEMA Act. It imposes penalties on

people involving in Hawala transactions. Hawala supports the parallel black money market which hampers the growth in the country. There have been many cases in India involving Hawala transactions. However, in spite of the Government imposing measures to abolish the Hawala transactions, it is still existing with huge amounts involved.

The question that arises is why use the Hawala system and not a conventional banking system? Although a traditional banking system seems and probably is a safer way to transfer money, Hawala is used a lot by immigrants who want to send money back to their families or vice versa. It is a popular way to move money because in comparison to the banking system, Hawala is cheaper, faster and less transparent. Hawala transactions as alternative remittances are flourishing and taking into consideration the FATF special recommendations is vital. The difficulty with these transactions is that they are entirely out of the radar and are unlike the western way of doing business. Another aspect is that successful Hawaladars at some point have to use the banking system in order to store loads of money (mainly for physical safety). This is a red flag for compliance professionals, as there is a big deposit of money without an apparent reason.

Therefore, compliance processes are crucial in order to dismantle bit by bit money laundering schemes and terrorist financing processes. Compliance officers or criminal investigators need to complete difficult puzzles, combining several years of experience and a holistic view on the transactions and the people behind them.