REGULATIONS FOR RETAIL REMITTANCES: COMPLIANCE ENTROPY IN STORE-FRONT TRANSFERS

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ABSTRACT

Australia's anti-money laundering regulations (AML/CTF) on money transfer businesses exhibit flaws. The internationally driven implementation of regulatory controls on money transfers now encounters compliance entropy as commercialization saturates traditional money transfer networks. At the micro level, a large number of shop front transfer businesses sell a variety of products and services in an informal retail environment which is built on familiarity and trust. Yet wire transfer business now competes alongside postal outlets that provide a myriad of products and services. They share retail interests with alternative remittance agencies operating in both convenience stores and independent currency exchange services. Retail remitters increasingly offer money transfers through providers such as Western Union, MoneyGram and Ezy Money. This paper posits that regulatory compliance levels have decayed in money transfer stores. Retail transfers in shop-front money transfer business practices have increased the risk of money laundering significantly. The results from a sample of Australian store-front transfer businesses (n=42) found that 58% of stores exhibited non-compliance with Australian anti-money laundering regulations. The results point to an emerging trend of decay in retail-based shop-front remittances and the need to re-evaluate AML/CTF in the retail sector.

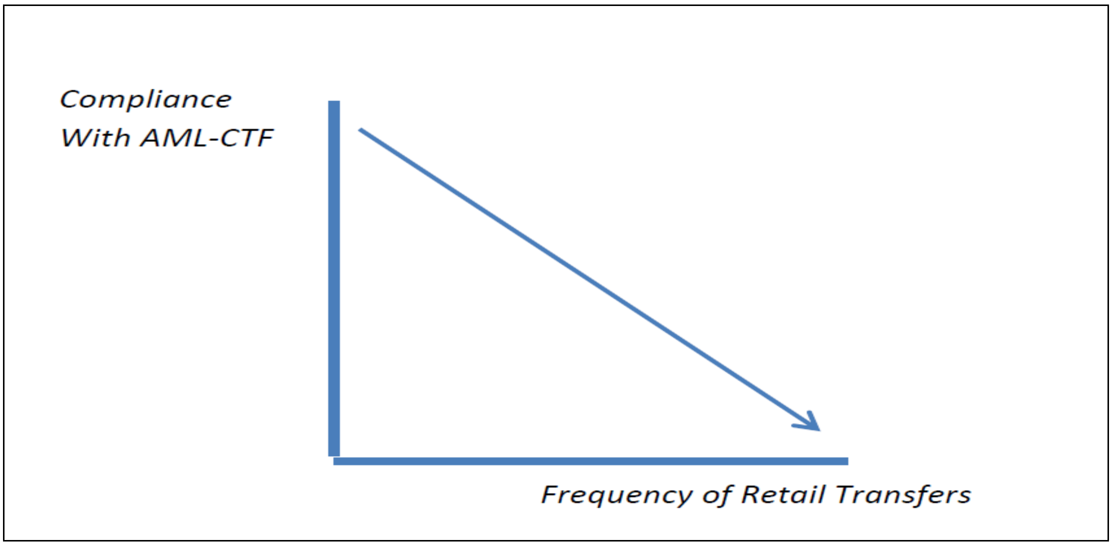
Keywords: *Australia, anti-money laundering, counter-terrorism financing, regulatory compliance, customer identification, alternative remittance/money transfers, cultural awareness*

INTRODUCTION

Money laundering not only represents a significant risk to the effectiveness of the global economy; it is also a pervasive danger to individuals who send funds through money transfer systems. Many nations now take steps aimed at preventing the funding of dubious activities from the transfer of money. In general these aims are to attain greater control over currency transfers which cross international borders. The overall result of this movement has seen international standards set under which traditional and formal transfer systems are subject to more rigorous regulatory control, and 'Western' states have developed a high level of intolerance for hidden systems of money transfer such as Hawala and Hundi (Cook and Smith, 2011a; Maimbo and Passas, 2005; Rees, 2010; Perkel, 2004).

Most Anti-Money Laundering projects successfully identify small numbers of transfers dealing with large sums of currency. The more difficult area to identify and mitigate is where there is a greater frequency of transfers and relatively smaller sums of currency. Whilst "Formal Transfers" and "Covert Transfers" operate at the two extremes of the money transfer industry; it is the middle ground of 'semi-formal' funds transfers, and their prevalent use by everyday citizens, which characterise' the hub of this discussion (see Figure 1).

Figure 1: Decay in Compliance with AML-CTF in Retail transfers



This paper draws on data collected from store-front money transfer businesses which highlights a trend of decay with compliance under Australian Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) legislation. The purpose of this paper is to demonstrate that in more commercialized areas of retail money transfer business; the effectiveness of Australia's AML regulation of money transfers requires renewal. We first contextualize the state of the Australian alternative remittance sector, followed by a discussion on a sample of data displaying regulatory entropy against retail-based store-front money transfers. Finally we indicate the need to implement improvements aimed at reducing decay in Australia's retail money transfer providers.

BACKGROUND

Over the last century, the human race has exponentially developed its pathways for the transfer of wealth and property. Through technology and a culturally ingrained drive for infinite growth and prosperity, a majority of the world's population now fights for survival and relevance within a globalised social Darwinism of economic exchange. Through the laundering of funds, organisations and individuals seek to mask their interaction with the regulated and the 'dark' or 'black' side of the global economy. Yet increasingly the retail portion of such transfers are less aligned to survival of the fittest but rather they are closely mirrored by the notion of success for those who survive through what Peter Kropotkin (2012) refers to as survival of those who "cooperate". Thus the emerging characteristic becomes the ability of larger numbers of people to engage in transfers through the help and cooperation of others. This is typically manifested in informal cultural, and social agreement rather than through strict regulatory compliance.

Citizens seeking to transfer money internationally may choose to do so at a bank through formal banking systems or alternatively may choose to use a semi-formal system through a postal business. Semi-formal systems come under the category of alternative remittance systems (ARS) since they do not carry the same formal characteristics as banking institutions. Australia Post recommends the Western Union international money transfer service and supports its availability through almost every postal outlet in Australia (Post, 2012 c). Whilst formal banking transfers have a high level of compliance with Australian transfer regulations, the semi-formal segment of the money transfer industry has lower levels of compliance and therefore deserves scrutiny in the face of increased volumes of international funds transfers (AUSTRAC, 2010). Australia's postal outlets make up a significant percentage of the nation's registered alternative (semi-formal) remittance providers (AUSTRAC, 2011; Post 2012 a). This paper examines the Australia Post-Western Union business model under the hypothesis that the transfer system is at significant risk of exploitation through the decay in identification verification. The increased focus on the formal and hidden extremes of funds transfer have taken the spotlight away from large volumes of transfer business that takes place within semi-formal frameworks.

As an alternative remittance (i.e. money transfer) provider, Australia postal agents and their staff are obligated under law to take a number of steps to reduce the risk of money laundering through their business (AUSTRAC, 2007; Australia, 2012). However, despite revamped regulations under the Australian Anti-Money Laundering and Counter Terrorism Financing Act of 2007 (ibid), sample data shows a non-compliance to identification requirements in postal offices. A sample of Australia

Post outlets (*n=23*) revealed systems-based decay in records management and the regulatory compliance of identification when Western Union transfers were carried out in Australia Post stores. As the number of customers has increased over time, and the popularity of semi-formal transfers has also increased, decaying adherence to regulations has begun to appear. Australia Post conveys the outward appearance of high-level compliance (based on its history and on public perception of trust in the postal system), yet fails to demonstrate the same exacting standards expected of the National postal service provider. This paper posits that compliance with identification standards has decayed in Australia Post outlets as they have shifted from post 'masters' to postal agencies. Compliance entropy increases the risk of exploitation in postal services offering money transfers (see Figure 2).

Figure 2: Categories of Money Transfer

Remittance Service Categories	Remittance Characteristics and Brand Examples
Formal Transfer Focused	• No secondary business goals. • Transfers only to specific countries. • (i.e. iRemit)
Semi-formal	• Transfers may be secondary to main business. • Transfers to many different countries. • Provides online services. • Operates out of a shop front. • Advertises to the public. • (i.e. WU, PayPal, MoneyGram, Ez Money Express and UAE Exchange).
Covert Non-aligned	• Operates out of an unlikely premise (i.e. Taxi, Restaurant, Butcher, Ethnic Video Store, and Private Residence). • Not Brand Affiliated. • Relies on word of mouth and familial networks instead of advertising. • Hawala, Hundi, and Black Market Peso style operations.

REGULATORY CONTROL AND MONEY LAUNDERING

To gauge the importance of decay within Australia, it is important to consider the worldwide context of regulatory control and money laundering. Internationally, the global financial system is consistently under threat of being undermined by the 'black market' economy (Masciandaro, Takats & Unger, 2007). Legitimate trade carries with it the burden of illegal and poorly regulated transactions which are harmful to society, yet remain in demand (ibid). International financial transactions include remittances involved in weapons, human trafficking, corruption, and violent conflict (APG, 2011; Moore, 2001; Sullivan & Smith, 2012). Moreover the illegality, subsequent high profitability, and constant consumer demand associated with black market trade ensures a steady line up of criminal entrepreneurs and finance dependent extremists (Levi & Reuter, 2006; Reuter & Truman, 2004).

The United Nations Office on Drugs and Crime (UNDOC) (2012), estimates that a global total of USD$870 billion is earned annually from criminal enterprise. Subsequently criminals disguise the origins of the funds through 'money laundering', in order to avoid detection and prosecution (Kochan, 2005; Levi & Gilmore, 2003; Levi & Reuter, 2006; Masciandaro et al., 2007; Napoleoni, 2004). In order to push anti-money laundering policy and good governance, the Financial Action Task Force (FATF) operates as the peak anti-money laundering body (FATF/OECD, 2011; FATF-GAFI, 2012; Masciandaro et al., 2007; Reuter & Truman, 2004).

Money Laundering

Money laundering is commonly described as a three step process (Irwin, Choo, & Liu, 2012; Levi & Reuter, 2006; Reuter & Truman, 2004). The purpose of money laundering is to obscure the origin and identity of funds, property, and valuable assets (ibid). The three stages are known as Placement, Layering, and Integration (see figure 3). Stage one entails placement of the discretely sourced funds into the legitimate economy. Step two is where funds are distanced from its source, and step three is where funds are integrated into the legitimate economy under the guise of validity (Choo, 2008; Irwin et al., 2012; Levi & Reuter, 2006; Reuter & Truman, 2004).

Figure 3: The Three Stages of Money Laundering

Stages of Money Laundering	
1. Placement	Introduction of funds or asset to legitimate financial system.
2. Layering	Distancing funds or asset from source origin, whether criminal or legitimate.
3. Integration	Change of funds into legitimate income via standard business or fiscal enterprise.

Fig 1. (Choo, 2008; Irwin et al., 2012; Levi & Reuter, 2006; Reuter & Truman, 2004)

In the case of a criminal venture this would be when the funds are invested into a legitimate business enterprise or other investment avenue. However in the case of funds intended to finance terrorism, integration would not likely occur (Irwin et al., 2012; Levi & Reuter, 2006). Similarly when examining the placement of funds, some remitters may source their assets or funds legitimately, but will seek to disguise the origin of their funds (Choo, 2008; Irwin et al., 2012; Levi & Reuter, 2006; Reuter & Truman, 2004). Semi-formal transfer businesses are increasingly popular for two disparate reasons. On the one hand they give criminals the opportunity to pepper their transactions amongst the high volume of other legitimate transactions. On the other hand, they allow a perceived diminution of regulatory compliance because the high volume low transaction amounts carry the perception of a low risk to AML-CTF rules. The semi-formal retail sector therefore enjoys a culture of low risk-low compliance when small transactions are frequently applied.

The Changing Culture of Alternative Remittance in Australia

Alternative remittance systems (ARS) and their stakeholders, also known as informal value transfer systems (IVTS), remain at the forefront of risk assessments into terrorist financing. ARS is characterized by its informal elements, its approach to record keeping, minimal staff training, and informal customer relations. In contrast a bank often has significantly more "authorized" information about each customer. It offers high standards of staff training, and keeps accurate and historically relevant records. The term KYC refers to the 'Know Your Customer' policy that allows banks to re-assure themselves about each customer according to their habits, their employment, and their limitations. They do this in order to satisfy themselves of a customer's identity and the non-repudiation of their records. This information is beneficial for AML/CTF policies when institutions want to reassure themselves of a person's suitability to transfer money internationally.

In contrast alternative remittance providers do not keep the same level of historical record keeping. Remittances are largely viewed as 'one-off' individual transactions. The need for identification of both senders and receivers is therefore more important, since there is no other verification of suitability in place to inform the regulatory process of restricting terrorist finance through funds transfer. Since September 2001 governments have watched those at the most unregulated end of the spectrum (i.e. Hawala and Hundi) because no identification records are retained and no transaction history can be recovered. However the alternate remittance traffic from semi-formal entities such as Western Union is significant because it is both high in volume (remitters) and high in frequency (transfers). Sponsors of crime have shown the propensity to route funds through multiple systems, using the cover of normal everyday transactions to mask their intentions. Transfer businesses (such as Western Union) deserve as much, if not more, attention as those remittance agencies at the unregulated extremes of informal transactions. The majority of these transfer businesses do not keep the same level of KYC focus as their banking counterparts.

Interestingly, alternative remittance systems at the most informal end of the transfer market such as Hawala and Hundi actually do display elements of a KYC philosophy. This is because they operate on the foundations of familial relationships and trust (Cook & Smith, 2011), and were first created for the transfer of currency between towns and provinces throughout the Middle East and South Asia. Today these ARS systems have international reach and often act as a lifeline into developing nations (Napoleoni, 2004; Passas, 1999; 2003; 2006). The most common use of these systems are for expatriates as a low cost and familiar avenue to transfer money home, and also as a resilient economic system for countries in conflict to receive aid when formal systems have failed (Maimbo, 2003; Maimbo & Passas, 2005; Rees, 2010; Razavy 2005).

KYC Decay

Over the last two decades the alternative remittance industry has grown to include wire transfer services (Western Union, Ezy Money, MoneyGram etc). These wire service transfer systems compete with traditional informal systems such as Hawala and Hundi. They represent the middle ground between formal banking systems and unregulated and illegal familial systems. They seek to compete by offering something from both sides of the transfer market. On the one hand they are semi-formal, often located as 'agencies' within convenience stores, markets and Australia Post stores. They do not demonstrate the same officialdom of the big Banks, yet purport to offer similar security of transfer as the banking fraternity. Within this semi-formal grouping, Western Union is of significant interest since its business model allows for agencies in both the informal setting of convenience stores as well as the formal domain of the Australian Postal service. Australia's anti-money laundering and counter-terrorism financing framework has consistently taken a hard-line approach to the regulation of informal transfer systems (AUSTRAC, 2007 a; 2008; 2009; 2010; 2011), however the focus has always been on systems that outwardly appear to embrace the least formal end of the market. Hawala operations have been largely forced underground whilst large numbers of transactions receive less scrutiny if they appear within the perceived legitimacy of the Australian Post stores.

The new trusted middle ground for semi-formal transfers

Semi-formal transfers now patronise shop-front businesses in either wire-transfer companies or postal businesses that are more like shops than 20th century traditional organisations that previously operated as government departments. The commercialisation of Australia's postal commission into a corporation in 1988-89, has brought about significant changes to its structure and operation (Post, 2009; Government, 2011). These businesses now operate under a legal framework as set out in the Australian Postal Corporation Act 1989 (APC Act). Postal businesses now run in a commercial manner (i.e. carry out functions in an efficient and profitable manner) (Government, 1989). In line with this obligation Australia Post funds its own activities, pays tax, and must pay a dividend to the Australian government (Government, 2011). Thus in Australia the postal services have transformed into a retail giant which turns over approximately AUD $5 billion in revenue annually (Post, 2011; Post, 2012 e), and paid a $173 million dividend to the Australian government at the end of the 2010-11 year (Post, 2011).

The Australia Post Corporation provides over 100 different products and services to local communities (Post, 2012; 2012 a). The 2012 Australia Post annual report highlights the results of a consumer brand trust survey which holds Australia Post as the second most trusted by consumers in the retail sector (Post, 2012 e). Those products sold under the Australia Post umbrella enjoy the public perception of trust as extended throughout each store. However, the staff and employees of these Australia Post agencies no longer operate as formally as their 20th century government counterparts. The renewed focus on commercial profit translates into changes in staff, and staff training.

Australia Post and Western Union

A study was carried out in order to determine the level of legislative adherence in Australia Post outlets regarding identification requirements and Western Union money transfers. Under the Australian AML/CTF Act 2007, money transfer agents have an obligation to accurately identify their customers, as well as create and store detailed records of every transaction (AUSTRAC, 2007; Australia, 2012). This means that under law all transfers must be recorded with the customer's details taken down from 'primary photo' identification, or a legislated equivalent (ibid). (See Figure 4)

Figure 4: Requirements for Primary Photo Identification

Primary Photo identification
National or International Drivers License.
National or International Drivers License.
International passport issued by foreign government or U.N.
International passport issued by foreign government or U.N.
A national identity card issued by foreign government or U.N. with a photograph and signature.

AML/CTF Act 2007 (AUSTRAC, 2007)

Student identification was not considered primary or secondary valid identification, and as such government issued identification must be sighted and recorded in order to comply with AML/CTF legislation (AUSTRAC, 2007; Australia, 2012).

METHOD

A sample of Australia Post stores was carried out between April 2012 and August 2012. The sample examined alternative remittance agencies operating in Australia. Respondents were asked to explain what level of identification was required in order to make an international money transfer using Western Union of between $300 and $1500. Information was recorded along the lines of a standard customer enquiry to front-line Australia Post staff working in stores that offered and promoted the Western Union money transfer service as the preferred method of money remittance.

The sample of Australian postal stores (*n=23*) looked at the two main types of postal stores. Some stores operate as Licensed Post Offices (LPOs), whilst others are franchised that operate under a highly regulated business model which mirrors the Australia Post 'licensed' store, to the extent that ordinary customers would have difficulty in determining one from another. Both types of stores offer the standard range of additional services as outlined in Figure 5.

Figure 5: Range of Services at Australia Post stores

Australia Post Services
Postal Services
Passport and License Application
Bill Payment
Travellers Cheques
Foreign Currency Exchange
Stationary
Entertainment and Educational Media and Software
Commemorative Collectibles
International Remittances (Western Union)

Fig 5. (Post 2012, ;Post, 2012 c).

DISCUSSION

The sample of post offices sees the results fall into two categories. There were 2,934 licensed Post Offices (LPO's) and 29 franchised stores (Post, 2012). Both categories offer products and services that include but are not limited to; providing complete passport and license application services, bill payment, travelers checks, foreign currency exchange, stationary, entertainment and educational media and software, and commemorative collectables (Post, 2012). Both sets uphold international remittances through the globally recognised ARS, Western Union (Post, 2012 c) by providing transfer services for the agency in each store.

The results from the study showed that 70.6% of licensed postal staff, and 66% of franchised Australia Post staff, expressed a willingness to accept student identification for a large international money transfer (see figure three). In contrast, formal remittance providers such as banks require primary forms of photo identification and would not accept student identification as a suitable substitute. In the case of banks, student identification can be used as part of a collection of identification material (along with other forms of ID) to make up a satisfactory identification profile, however student identification does not constitute sufficient identification as a stand-alone instrument. Postal stores where employees showed reduced interest in the need for Primary Identification for money transfers, shows a decaying compliance with AUSTRAC regulations. Given the requirement of Australia Post employees to also carry out other services where they are obligated to record the name and number from Primary Photo Identification, it is problematic that money transfers do not receive the same scrutiny.

Figure 6: Identification Requirements in Australia Post Outlets

Accepted ID	Australia Post (Licensed Post Office) using Western Union	Australia Post (Franchised Post Office) using Western Union	Total
Primary Photo I.D.	29.4%	33.3%	28%
Student I.D.	70.6%	66.6%	72%
No I.D.	0	0	0
Total	68 %	24%	*n=23*

As postal stores engage in competitive behavior with other commercial enterprises they adopt the commercial helpfulness that replaces the bureaucratic approach which covers passport licensing. Selling commemorative memorabilia or souvenir stationery aligns more readily with sales activities such as customer service and friendly courteous customer engagement. At least part of the postal business model places renewed emphasis on friendliness and good service (Post, 2012 e). In approximately two thirds of cases a student ID was deemed sufficient for an international transfer. Where Post Offices previously operated under strict Commonwealth guidelines, they now serve a more commercial existence.

Figure 7: Comparison of Franchised and Licensed Post Offices

Franchised Post Office	Licensed Post Office (LPO)
Access to Management & Business Systems.	Access to Management & Business Systems.
Comprehensive training to be completed before agreement begins and on-going professional training and support.	All training of staff is mandatory and the responsibility of the owner.
10 year term with exit payment on expiration	License has no set term and can be assigned at any point.
Shared ongoing revenue.	Income dependent on fees and commissions relative to work performed.
Shared risks and benefits to both parties.	All risk is carried by the licensee.
• No capital outlay for fit-out or stock. • Fully equipped outlet with stock provided on consignment • Franchisee only pays running costs and rights fee to Aus Post.	Licensee pays fees for all start up and any maintenance.

Fig 7. (Post, 2012 b; 2012 d)

Licensed post and franchised stores differ greatly in operational size and structure (see figure 7). An LPO manager is responsible for the comprehensive training of all staff and receives support for training staff. Yet the level and type of support provided is generalised across standard practices (Post, 2012 d). In contrast, a franchisee is provided with comprehensive training before the store opens and receives on-going professional training and support from Australia Post over its ten year term (Post, 2012 b). Licensed post managers carry the entire burden of risk, cost of stock, labour, training, and on-going maintenance of the business (Post, 2012 d). However an LPO has less managerial restriction, is easier to access, and has a higher potential income and less recurring fees (Post, 2012 b; 2012 d).

Limited staff knowledge and understanding

Australia Post staffs have less procedural training than the postal services staff of the previous generation. This exposure is partially due to the larger number of services these stores provide. Current employees are required to understand the correct procedure for over 100 different services, as well as ensure compliance with AML/CTF obligations in the operation of Western Union transfers. The understanding required to effectively provide Australia Post services represents substantial regulatory commitment for little additional commercial reward.

The competitors to transfer businesses (such as Western Union) are no longer from the banking sector. Instead the natural competitor is a different remittance agent that may operate from a convenience store, a newsagent, or even a late night kebab shop (Cook and Smith, 2010). Under these conditions the development of a sustainable business relies on the repeat transactions from customers who feel comfortable in using a service. Repeat business becomes dependent upon friendliness and customer service. Issues such as ID regulations can be downgraded in favor of regular custom from reiterated transfer business. Thus the same familial trust characteristics of competing remittance agencies change the staff emphasis from bureaucracy to rapport. Transfer regulation compliance begins to decay whilst customers seek to establish ongoing transactions with those remittance agencies that demonstrate stronger bonds and affinities (see figure 8).

Figure 8: Decay versus Business

Decay versus Business
Decreased formality/ bureaucracy = Increased Compliance Decay
Increased Customer service = Increased Business

CONCLUSION

There is a need to re-evaluate AML/CTF strategies onto retail-based semiformal transfers. Money transfers are taking place in postal stores without the full compliance of primary photo identification as required for international remittances. Notwithstanding the limitations of the relatively small sample size (*n=23*) in this research, even a single breach of compliance would warrant further inquiry. The large number of non-compliant circumstances recorded here, indicate the need for further research into mid-sized remittances from within the retail segment of the money transfer industry. Money Transfer business that is derived through affiliations with postal stores have issues in terms of anti-money laundering regulatory compliance. Retail services and products distract staff and employees away from regulatory obligations. The threat of money laundering through wire transfer systems attached to postal stores is rising.

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