Italy: money transfer, money laundering and intermediary liability

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Abstract

Purpose – This paper aims to offer a general overview of money transfers in Italy and Europe focussing specifically on the migrant community. This is of particular interest because it is in that community where money transfers are most prevalent. This shows the money transfer system as a tool that could guarantee the financial inclusion of migrants but at the same time being used in a distorted and unlawful manner.

Design/methodology/approach – After a brief introduction focussed on working principles and legal frameworks, the paper will go deeper in evaluating money transfer data. This data, which comes from various legal authorities, will show the extent to which different migrant communities who reside in Italy are able to carry out illicit activity using money transfers. It will also highlight the existence of legislative inconsistencies through a case by case approach.

Findings – This paper shows the reason why people find it relatively easy to use money transfers to launder money or in a broader sense, take part in other illicit financial operations such as financing terrorism.

Originality/value – This study will examine recent Italian criminal cases concerning the unlawful use of money transfers. This paper is the original study of the author and has not been submitted elsewhere for publication.

Keywords Terrorism financing, Migrants, Remittances, Money dirtying, Money transfer, Suspicious transactions, Money laundering, Smurfing, Flow of values

Paper type General review

1. Introduction – formal and informal money transfer providers

A money transfer is an act of transferring money from one place to another. Basically, money transfer is a financial service, which involves the acceptance of cash, cheques or other monetary instruments on the one side, and the payment of a corresponding sum of cash or other forms of credit to a beneficiary on the other side. This can happen by means of communication, messages, transfers or through a network to which the money transfer provider belongs. This means that these kinds of transactions and the use of this particular service may include the use of one or more intermediaries and also a final payment to a third-party (Financial Action Task Force, 2016, p. 7).

One of the main features of a money transfer is that it allows people to quickly transfer money from one country to another, safely and at a relatively low cost. This is why money

Journal of Financial Crime
Vol. 30 No. 2, 2023
pp. 377-388
Emerald Publishing Limited
1359-0790
DOI 10.1108/JFC-10-2019-0137

transfers are the main method used by migrants to send sums of money to their country of origin (Clemente, 2016, p. 4; Talarico, 2012).

It is important to mention that in these kinds of transactions there is no need for the funds to pass through the bank accounts held by the person who is paying or by the beneficiary. Money transfers, in fact, work via monetary compensation, so the people involved do not need to have a bank account as the transfer itself will be made through the bank accounts held by the money transfer providers.

If we take a closer look, it can be seen that the money transfer system works like the original money transfer providers in history – the Templar Knights (Palana, 2010). They were the first to implement an international money transfer system. This is how the Templar Knights helped pilgrims on their way to the Holy Land to safely transfer the financial sums that at the time were necessary to carry out their mission. If we look at history, we can see how this first form of bank transaction made the Templar Knights so powerful – they were greatly feared and were ultimately overthrown, but remain an example of the extent to which power belongs to those who provide money transfers, even today.

The first thing to do to better understand this topic is to draw a distinction between money transfers, which take place through formal channels or alternatively, via informal channels, because this paper is placing most emphasis on the former.

Firstly, when speaking about informal channels, it must be highlighted that there are methods for sending money, which do not use operators or channels controlled by the authority in charge of monitoring and protecting the movement of money. It may be easier, for instance, to entrust cash that someone is intending to transfer to the country of origin to a trusted person – such as a relative or friend – who is returning to that particular country (Palumbo, 2015); this is the first example of informal money transfer. However, there are some more organised informal money transfer channels in other areas.

Hawala (Jost and Sandhu, 2000), Mudaraba, Stash House and Chop Shop (Palumbo, 2015; Financial Action Task Force, 2013) are some of the most popular informal money transfer systems. They have been used for a long time, and there are reasons why they still represent an interesting choice for customers. First of all, compared to formal channels, they are cheaper and simpler to use, mostly because they do not need particular formalities to be done; this is why they number at least 30 per cent of the money transfers that flow from Italy to abroad (Oddo *et al.*, 2016; Carli, 2018). However, all these aforementioned systems work in a similar way, mostly because they are based on unwritten rules or on trust. On the other hand, informal channels are less secure than formal ones, especially in terms of uncertainty about costs, times and the potential risk of losses faced by customers. Moreover, there is no written agreement, so customers cannot prove the existence of the transaction and, finally, legal authorities cannot monitor and control cash flows made through these informal channels (UNICREDIT, 2014). These unmonitored circuits of financial exchanges and transfers of funds present huge risks both in terms of money laundering of cash that has an illicit origin or in terms of funds related to international terrorism (Palana, 2010, p. 3). In fact, we tend to underestimate the financial side of terrorist attacks that can have such a devastating impact – Charlie Hebdo, the Bataclan or the 2007 London underground attack are just a few examples illustrating that huge funds are not needed (Patti, 2016).

The Guardia di Finanza – the Italian police force that investigates economic crime – has proven that many foreign groups use money transfer as a tool to launder cash of illicit origin or to send money to a terrorist (Simone, 2005) – but we will look at that in more detail later on.

Formal channels, meanwhile, are the ways in which we can spend money with the use of operators or tools regulated by the law and controlled by the same authority that monitors financial movements. These formal channels have two main features as follows: there are specific laws regulating their activities and services and there is an authority who controls and monitors them. Anyone who wants to send money through a formal channel gets a receipt, which proves the existence of the contract. The intermediary is responsible if he fails to accomplish the requested service – therefore, whatever happens, it will be possible for the customer to enforce what is written on the contract by going through the controlling authority or taking the matter to court. Of course, formal channels may be more expensive compared to the informal ones, and they will need various legal requirements – like a detailed customer identification, for instance – to get the agreement confirmed but this means that the contract is registered and either party has legal rights in case the deal goes wrong.

2. Working principles and intermediary liability

It seems that, at this point, one strong question arises: how does a money transfer practically work? Typically, a money transfer provider (or a sending agent acting on behalf of a money transfer provider) accepts the funds or values to be transferred, collects the required identification customer information, gives a money transfer control number to the sender, at the same time enters the transaction and sender's applicable identification information within the system. These payment details are forwarded to the pay-out agent at the destination point, which will provide the funds to the beneficiary identified via the money transfer control number (previously delivered to him by the sender). The message is either sent directly from agent to agent or through a clearinghouse that serves as a central hub. Finally, values are available to the final recipient, in the appropriate currency, from the hands of a receiving agent located in the paying jurisdiction and acting on behalf of a money transfer provider. The receiving agent will also collect and maintain the required identification information at the point of destination in accordance with the local applicable law.

As already explained, this system works through compensations; pay-out methods could differ by jurisdiction but may include cash, cheque, money orders, pay-out cards, mobile wallets, bank deposits or a combination of these elements (Financial Action Task Force, 2016, p. 8).

Basically, the customer who wants to send money gives it to the money transfer agent; the latter will transfer the payment details to the receiving agent through the money transfer provider bank accounts. Money is then made immediately available to the final recipient and, after this payment, the agents complete the necessary transactions between them. The money transfer control number is very important and cannot be underestimated because the receiving agent can only deliver the money to the one who has that number – this means that the money-sender must keep the control number safe and ensure it does not end up in the hands of any third-party, otherwise the transfer operation could be compromised and he may be found liable.

Focussing on the liability of the intermediary, it can be said that he must be held responsible if he fails to transfer the sums when he is not able to demonstrate that the procedure, as established in the general terms of service, has been correctly followed. There are some cases involving the Arbitro Bancario Finanziario or financial banking arbitrator (ABF – the body that tries to find out-of-court solutions in banking disputes), which better explain when the intermediary can be considered responsible. For instance, the intermediary must be held responsible if he fails to keep the identity card of the sender, and there are not enough elements in the "to send money" form to double-check the identity of the receiver (ABF Milano, 1329/2010). On the contrary, the intermediary cannot be considered responsible if he correctly executes the order of transfer and payment in the terms desired and declared by the sender (ABF Milano 685/2014; ABF Roma 5307/2016; ABF Bologna 6134/2017; in the first example, the judges dismissed the case because the intermediary acted correctly in following the applicant's guidelines, while in the second and third cases the applicants were shown to be reckless having emailed the money transfer control number to third-parties).

3. European Union and the Italian legal framework

Money transfer is, therefore, a fairly simple method, but has a complex legal framework surrounding it. That European and Italian framework aims to help the payment services market to have low costs while at the same time maintaining adequate compliance safeguards for financial operations. This results in a wide range of legal provisions concerning international money transfers (Clemente, 2016, p. 6).

The decreto legislativo 385/1993 (act), also called "Testo Unico Bancario" (which is the main Italian legal text regarding rules on banking activity), is the main piece of Italian legislation, which regulates the banking activities performed by intermediaries or agents. However, national legislation must be coordinated with the European one – that is why there is a long history of legislative interventions within the European and national institutions regarding cash flows. The first Payment Services Directive (2007/64/CE, known as PSD1 Directive) and the 2009/110/EC Directive on the exercise and supervision of electronic money bodies (the so-called IMEL2) are the most important elements to take into consideration, essentially because they always need to be implemented in each member state through local legislation.

PSD1 Directive has been implemented in Italy through the decreto legislativo 11/2010 (act), which introduced a new body called "the payment institute" (Maresca, 2016). The payment institute is a financial operator, which oversees payment services like the money remittances. However, legislation has been renewed through the recent PSD2 directive, issued in 2015 and implemented in Italy because of the decreto legislativo 218/2017 (act) (Camera dei Deputati, 2019, p. 3). This new legislation introduces stricter requirements demanding agents and intermediaries to carry out a foolproof customer identification to avoid payments being made to people who may be different from the intended beneficiary.

What is really important to mention is that this complex legal system generates a regulatory asymmetry between Italian and EU intermediaries or agents (Galullo and Mincuzzi, 2017). In fact, only the operators who receive a mandate directly from an Italian authority (e.g. The Bank of Italy) are obliged to be included in a local public register. The decreto legislativo 141/2010 (act), which implements the 2008/48/CE Directive on consumer credit agreements reserves the financial intermediary activity to subjects registered in an official public register. However, as previously stated, this requirement involves only agents or intermediaries that are approved by the Italian authorities (Clemente, 2016, p. 7). This means that, as also happens with informal channels, Italian authorities do not know anything about European intermediaries' actions and cannot monitor the flows of money passing through their channels (Bonucci, 2017, p. 22). As a result of this tangled scenario, a payment institute based in one of the 28 European countries can use the authorisation received from that specific state to operate throughout the whole of the EU. This is the core of the "home country control principle" (Maresca, 2016, p. 4): briefly, the activity of a payment institution, which has been authorised by a particular country located in the EU will be controlled and monitored throughout the whole union by the authorities of that specific country. Clearly, each member state has its own legislation, so how a business chooses to make money transfers could naturally be influenced because some member states could ask for less stringent requirements than others – meaning a reduction in transaction costs. In other words, a money transfer provider might consider it more convenient to establish his “home” in a particular member state, one which has fewer, and therefore, cheaper requirements. Customers who want to use the money transfer as a laundering tool could also find it easier and safer to operate through EU intermediaries rather than through Italian operators, which are subject to heavier controls under the national authorities.

In fact, we’re not finished yet – there is even more to say! As already stated, many legal provisions are in place; but in addition to what we can define as “cash flow regulation”, this area of business is also affected by anti-money laundering regulation. The Italian decreto legislativo 90/2017 (act) implements the 2015/849/EU Directive, the so-called IV anti-money laundering directive (Castronuovo, 2017). One of the major results of this directive has been the establishment of some important principles aimed at establishing the “know your customer” approach in the member states. This approach can be considered as a customer because of the diligence requirement. The customer, in fact, will be identified by means of a valid identity document or a residence permit or any other relevant or useful document, of which the agent must keep a copy. In fact, the directive introduces some data storage obligations as a further safeguard to the lawfulness of transfer operations. Moreover, the anti-money laundering regulation obliges national and EU intermediaries or agents to report suspicious transactions, and this represents a precious tool in fighting money laundering, as we shall see Camera dei Deputati (2019, pp. 3-5).

At present, a new anti-money laundering European directive already exists (the V anti-money laundering directive) (Masi, 2019; UIF, 2019, p. 103). Moves to implement this in Italy began in July 2019 within the Italian Parliament, but they stopped as a government crisis arose, and as a result of the decreto legislativo 90/2017 (act) still remains valid. However, this is not the only piece of legislation currently in place: decreto legislativo 231/2007 (act), the so-called anti-money laundering decree, is still valid and sets a limit of €1,000 in money transfer operations (Parente, 2018). The existence of this limit is the reason why money transfers for laundering purposes are often made in low amounts and will sit just below the threshold – these are the famous – or indeed, infamous – smurfing cases.

4. Abuse of money transfer

It is evident that money transfers generate great concern in Italy and need specific attention, especially regarding transactions carried out through EU intermediaries or through informal channels, which, as already discussed, are harder to control. EU operators, in fact, are also affected by the aforementioned regulatory asymmetry, which makes them controllable only by the state who has authorised them to operate while informal channels are not part of any legal framework.

However, several criminal cases have been uncovered because of the reporting of suspicious transactions – one of the main tools used to fight money laundering operations (UIF, 2019, pp. 11-30). These have shown how formal transfer channels can be used by criminal organisations to launder significant financial flows. One of the best ways to identify suspicious transactions is to search for repetitive operations that make a transfer of money slightly lower than the limit established by law (UIF, 2019, p. 28). These modest-sized transactions, artificially set beneath the €1,000 mark, make up the core of “smurfing”, a practice that in recent years has been widely used especially – but not only – by Chinese migrants (Izzo, 2016).

Other risks come from "money dirtying". This is a phenomenon that mirrors money laundering – where dirty capital flows into a healthy economy. Conversely, clean capital can also flow into the dirty economy (Fara, 2018). However, to be clear, a large number of money transfers are made not only for laundering purposes but also to finance crimes like terrorism and human trafficking (Maresca, 2016, p. 2). Unlike in smurfing, these modest-sized transfers can often be difficult to differentiate from normal transactions, another reason why cases of terrorism financing are limited compared to the number of money laundering cases (Figure 1).

This chart shows data collected by the Unità d'Informazione Finanziaria per l'Italia – financial information unit for Italy (Clemente, 2016), which is based on reports of suspicious transactions, and it helps us see how few cases there are of money-dirtying when seen in the context of other reported cases. In fact, when looking at the number of money laundering cases (in blue) and those of money-dirtying (in red), the latter probably only represents the tip of the iceberg. However, even if the funding needed to plan a terrorist attack is relatively low, this problem is being addressed despite its low incidence in reported transactions (Laudati, 2002).

5. Cash flow coming out of Italy and investigations concerning migrants' remittances

At this point, other questions need to be addressed. How much money moves away from Italy and ends up abroad? To answer this, we need to look closely at transfers by migrants, because of this makeup almost all of the entire money transfer market (Marchetta and Bertoli, 2010). First of all, it must be taken into consideration that the available data comes solely from official money transfer channels, which are under the monitoring and control of the legal bodies: this means that they are essentially limited to formal channels. In 2010, considering a global money transfer flow of $440bn, Italy is the second country in Europe, after Spain, in terms of remittances. Until 2011, China benefitted most from transfers coming from Italy (€1.7bn). From 2018 things changed, with Bangladesh and Romania becoming the countries that received the most, and China falling to 38th place. This is all represented in the next chart (Figure 2):

This graphic is made up of data from The Bank of Italy (available at https://www.bancaditalia.it/statistiche/tematiche/rapporti-estero/rimesse-immigrati/), shown in millions of euro; it illustrates a decrease in payments sent from Italy to abroad through formal money transfer channels, which is mainly because of the switch of Chinese customers from formal

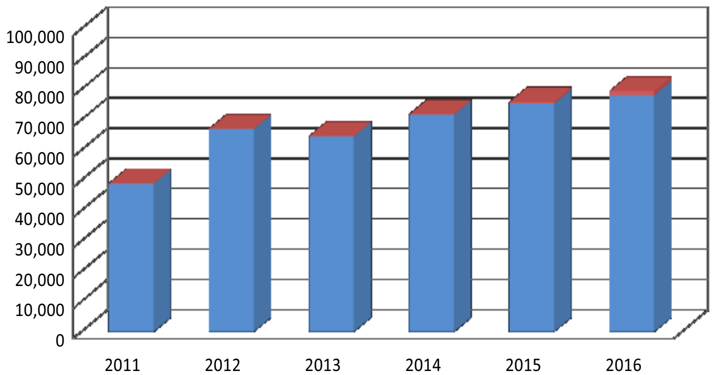

Figure 1. Comparison between money laundering and money-dirtying cases in Italy

to informal channels (Polchi, 2019; Galullo and Mincuzzi, 2017). As already mentioned, remittances from Italy start to rise again during 2017 because of money transfers made predominantly by Romanian and Bangladesh migrants.

The reason why remittances to China decreased so quickly is down to a large number of recent investigations, which affected Italy's Chinese community. This community now appears to use different methods for laundering money – in other words, via informal transfers. In addition, why are they doing this? To avoid detection (Barbieri, 2019).

The role of investigation is fundamental in finding out the methods and channels used by migrants in sending funds abroad. The first and most important investigation involved the Chinese migrant community, and that is why they can be considered as an excellent example of a case study.

Chinese migrants who reside in Italy often used money transfers to launder revenue coming from a wide range of criminal activities – not only from tax evasion and forced labour but also from prostitution, gambling or theft. In most cases, money transfer is not only incidental but also is a vital step in a carefully planned criminal process. This is done via the use of the so-called "captive money transfer" (Maresca, 2016, p. 2), which shows the operations carried out exclusively for criminal purposes.

One of the first and most important investigations was conducted by the Guardia di Finanza in Tuscany, between the cities of Florence and Prato, where the second largest Chinese community in Europe after that in Paris is to be found. From 2013 to 2015, the investigators examined the money transfer agency called Money2Money (Selvatici, 2015). The case looked at hundreds of identical money transfer operations, made in a very short period of time (sometimes even over a few minutes), between the same sender and the same receiver using the same low amount of money to try to circumvent the attention of the banking authorities. This criminal inquiry became famous and was known as "Cian Liu" (which means "river of money"). It was very important not only because it brought to light for the first time the illegal operations of Chinese migrants in Italy but also because it showed the involvement of the Italian branches of Bank of China, who failed to report a large number of suspicious transactions. As a result, four Bank of China officials were prosecuted amid a successful plea bargain in 2017 (Mugnaini, 2017).

Among other investigations, we should also mention the prosecutor's office of Milan, which in late 2016 found a sophisticated system of illegal money transfer agencies and companies based in Great Britain that we are able to transfer €2.7bn in almost three years (Rognoni, 2016). The basic idea behind these operations was to send money to a third country first – in this case, the UK – and then to China, in a bid to confuse the authorities. This was the first case in which one of the claimed crimes was a criminal association.

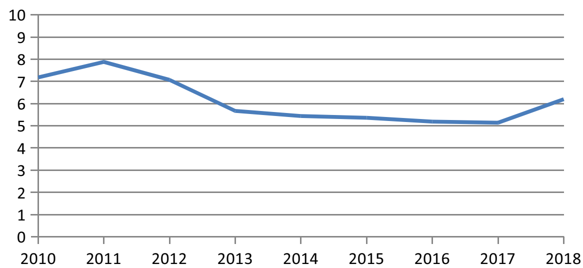

Figure 2.
Historical overview on remittances from Italy

However, other migrant communities use the same form of "captive" money transfer to launder money, and this has become more evident, as formal channels stopped being monopolised by the flow of Chinese money.

Indeed, other investigations should also be remembered: in 2015, almost €1m was sent from Parma and Reggio Emilia to Dubai and The Arab Emirates, even if there were no migrants from the Emirates in that specific area (Scullin, 2015). In 2018, the Guardia di Finanza discovered several money transfer operations in Ravenna made by the same agent representing four different intermediaries. The investigation started in 2017 after some banks reported a number of suspicious transactions made from the bank account of a money transfer agency located in the city centre (*Ravennatoday*, 2018). In 2019, the financial police in Verona identified cash flow of more than €3m towards the island of Ceylon, transferred over a period of one and a half years. This happened without the application of the necessary customer identification procedures, in a bid to circumnavigate reports of suspicious transactions. It must be noted that, from the beginning of 2018, Sri Lanka has been included in the list of countries at risk of money laundering and terrorism (Santi, 2019).

All this demonstrates that reports of suspicious transactions are one of the most effective measures implemented by the anti-money laundering legislation (Clemente, 2016, pp. 11-15); at the same time, as the Chinese experience shows, the more effective the investigations become, the less formal money transfer channels will be used.

6. Conclusions and solutions

As stated, the reporting system created by the anti-money laundering regulation could bring to light many more criminal activities. Meanwhile, informal money transfer channels are still not under control, and in Italy, they represent at least 30 per cent of all transactions. Furthermore, EU intermediaries are hard to control as well because of the aforementioned regulatory asymmetry and the features of the legal system.

Clearly, almost the entire money transfer system must currently be considered "dedicated" to the global collection and distribution of financial flows by the migrant community, as part of a fundamental and positive process of "financial inclusion", which would help protect the savings of individual migrants (Giangaspero, 2009, p. 13; Ferro, 2010, p. 32).

Enhancing the use of formal money transfer channels would help to direct the flow of value into the "official" financial system, otherwise, money would be controlled less and also located outside the legally protected financial system. However, by the beginning of 2019 a new tax regarding money transfers directed to non-EU countries was imposed in Italy (Bruno and Cimmarusti, 2018); this tax is based on the assumption that the income of migrants within the state's territory avoid or evade taxation, as that income is predominantly derived from unreported economic activity. Obviously, this new tax, due to a low 1, 5 per cent rate on the whole transaction, is not going to generate huge revenues, but it will discriminate against migrants. It seems that the low rate of taxation is not going to prevent negative consequences (Traversa, 2019).

In the end, this paper shows that there is no real perception and concrete knowledge of the entire money transfer phenomenon because it is not possible to control and monitor informal money transfers channels or EU intermediaries and agents. The data, as it exists, only comes from formal, authorised channels. Governments should concentrate their efforts to enforce the use of controlled and monitored transfer channels, but by establishing a tax – even if it is at a low rate – will certainly have an effect on the behaviour of migrants – if they want to avoid tax, they will behave to use less secure tax-free channels that are not monitored by the authorities. Along with the increase in criminal investigations, this will result in a rise in the use of informal channels.

Hopefully, the introduction in the Italian legal system of the new V anti-money laundering directive could help reduce the regulatory asymmetry between intermediaries and agents authorised by the Bank of Italy and other European central banks. This, in turn, should lead to greater control over transactions that are currently free from being monitored, and thus, prevent money transfers from being used for laundering purposes. The main problem is that money transfers lack security, and it is always difficult to find solutions, which provide security above and beyond the diligence of the involved parties. More international cooperation is needed to monitor and to better control the flow of money leaving Europe because making the money transfer safer is when all is said and done, a shared responsibility.

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