THE YEMENI FINANCIAL SECTOR: CHALLENGES AND OPPORTUNITIES FOR RECOVERY

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INTRODUCTION

The report is a collaboration between ACAPS Yemen Analysis Hub (YAH) and Mercy Corps Yemen Analysis Team (YAT).

The Yemeni financial sector plays a critical role in facilitating trade and import financing, providing banking services to the humanitarian and development sectors, and processing remittance flows into Yemen. With the Yemeni economy's import dependence and highly centralised nature, political control over Yemeni monetary and financial regulatory bodies and sources of foreign exchange (FX) supply are likely to play a key role in any peacebuilding discussions. The financial sector in Yemen is also not well understood. There is no single public-facing resource that can provide an overview of the system and the impacts of the conflict on its different components. This paper provides an overview of the current Yemeni financial sector, including developments resulting from the war and an understanding of political economy elements.

The purpose of this thematic paper on the Yemeni financial sector is to deepen stakeholders' understanding of the structure of that sector by highlight its complexities and risks. The paper intends to function as a foundational document and, as such, will not go into details about any single component. The research and drafting of this report were conducted between October–December 2021, with additional edits made in January–February 2022. ACAPS/YAT acknowledge key developments that have occurred during 2022, however these are not covered in the report- Key developments include the Russian military intervention in Ukraine starting February – and its impacts on international trade and financial market dynamics and domestic economies worldwide, including Yemen (Reuters 25/02/2022; UNICEF 11/06/2022). There are also the more encouraging developments that have occurred since April 2022, which could yet result in increased and sustained positive gains for Yemen's financial sector – noting the separate USD 2 billion pledges that the Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE) made on 7 April 2022 and the additional USD 1 billion worth of support from the KSA in the form of fuel and development aid (Reuters 07/04/2022 and 16/05/2022).

OBJECTIVES OF THE REPORT

The main objective of this report is to support actors working in Yemen by providing an overview of the current situation of its financial system.

The specific objectives for the stakeholders who will use the report include:

- to enable an understanding of the current state of the Yemeni financial system
- to raise awareness of the key challenges and risks that may affect external actors' efforts in using or supporting the system

METHODOLOGY

Initial research took place from October–November 2021, including a literature review to obtain relevant background and contextual information for the study. The research team used remote semi–structured interviews as the main data-gathering approach. Overall, they conducted 22 key informant interviews with key local and international stakeholders in November–December 2021.

ACAPS/YAT have a moderate degree of confidence in the reliability of this report, despite the limitations of some of the primary data. Given the political and economic sensitivities around the Yemeni financial sector, most key informants only agreed to share information if not directly quoted in the report. The report does not claim to be a definitive breakdown of the Yemeni financial sector, yet it intends to provide critical information and analysis of the sector.

KEY FINDINGS

Preconflict reliance

- Many banks suffer from a preconflict reliance on Central Bank of Yemen (CBY) FX financing, large treasury bill investments, and the holding of CBY accounts frozen since 2016.

Weaker position

- Political economy dynamics influence Yemen's banking and regulatory bodies and are a significant source of weakness in the system.
- Limited Anti-Money Laundering (AML) and Combatting the Financing of Terrorism (CFT) capacities, in conjunction with the fragmentation of the Financial Information Unit (FIU), have also left banks in a weaker position.

Economic competition

- The economic competition between the de-facto authority (DFA) in the north of Yemen (also known as the Houthis) and the Internationally Recognized Government of Yemen (IRG) has led to the fragmentation and bifurcation of key economic state-institutions, the local currency, and monetary policy, affecting the financial sector.
- The competing claims to authority over and attempts to regulate the financial sector threaten to cause significant damage to Yemeni banks and money exchange companies that will be difficult to undo.
- The de-facto split in the Yemeni currency has lead to the escalating loss of its value

Money exchangers

- The additional international bank de-risking of Yemeni banks during the conflict contributed to the shift in Yemen's financial cycle from Yemeni banks to money exchangers.
- Money exchangers grew in number and importance during the conflict and started engaging in several key financial services that Yemeni banks previously provided – particularly in terms of trade financing, with money exchangers becoming the primary destination for deposits and source of credit for traders (including importers).
- Money exchangers play a central and critical role in the economy and for a much broader section of the population than Yemeni banks, largely because money exchangers are more accessible to the public, have been able to maintain a sustained flow of funds, and have wide and comprehensive networks.

Microcredits

- There is scope for microcredit extension to the most vulnerable segment of the population and livelihood ventures despite the limited success shown by the current microfinance institution (MFI) model.

Judicial system

- A dysfunctional judicial system undermines the financial sector by making failure to abide by contract terms a low-risk activity.

Innovation

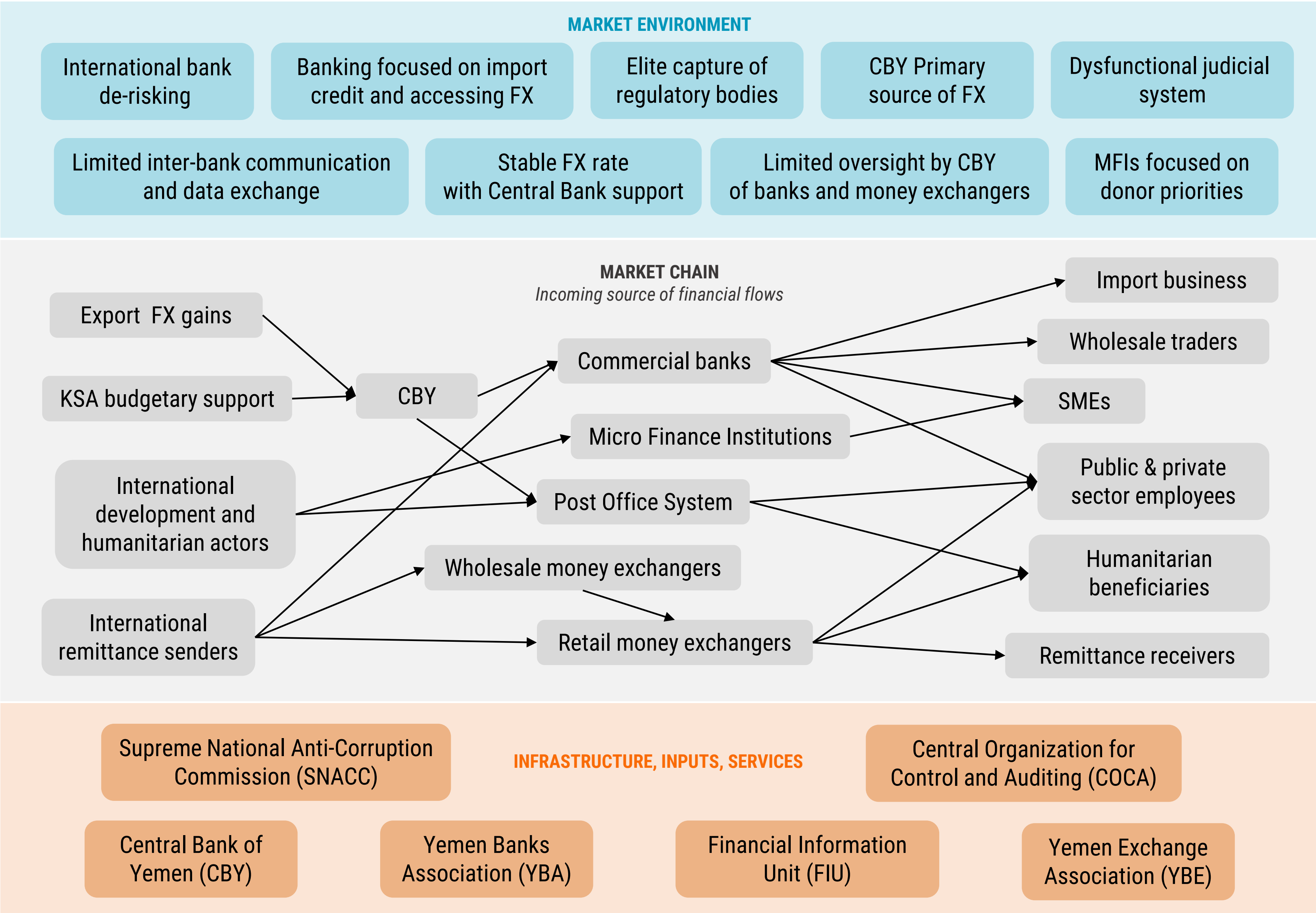
- There have been few financial service innovation attempts since the start of the conflict, with the banking sector lacking in competitiveness and innovation by nature.

ACRONYMS AND ABBREVIATIONS

AML	Anti-Money Laundering
CAC Bank	Cooperative and Agricultural Credit Bank
CBY	Central Bank of Yemen
CBY Aden	Central Bank of Yemen Aden
CBY Sana'a	Central Bank of Yemen Sana'a
CFT	Combatting the Financing of Terrorism
COCA	Central Organization for Control and Auditing
DFA	de-facto authority in the north of Yemen (also known as the Houthis)
EU	European Union
FIU	Financial Information Unit
FSP	financial service provider
FX	foreign exchange
GoY	Government of Yemen (used referring to preconflict)
IBY	International Bank of Yemen
IMF	International Monetary Fund
INGO	International nongovernmental organisation
IRG	Internationally Recognized Government of Yemen
KSA	Kingdom of Saudi Arabia
MENA FATF	The Middle East and North Africa Financial Action Task Force
MER	mutual evaluation report
MFIs	microfinance institutions
NBY	National Bank of Yemen
OSESGY	Office of the Special Envoy of the Secretary-General for Yemen
RCO	Office of the Resident Coordinator
SAR	Saudi riyal
SFD	Social Fund for Development
SMEs	small and medium enterprises
SNACC	Supreme National Anti-Corruption Commission
SWIFT	Society for Worldwide Interbank Financial Telecommunication
UAE	United Arab Emirates
UN	United Nations
US	United States
YBA	Yemen Banks Association
YBC	Yemen Businessmen Club
YBRD	Yemen Bank for Reconstruction and Development
YEA	Yemeni Exchangers Association
YER	Yemeni rial
YKB	Yemen Kuwait Bank

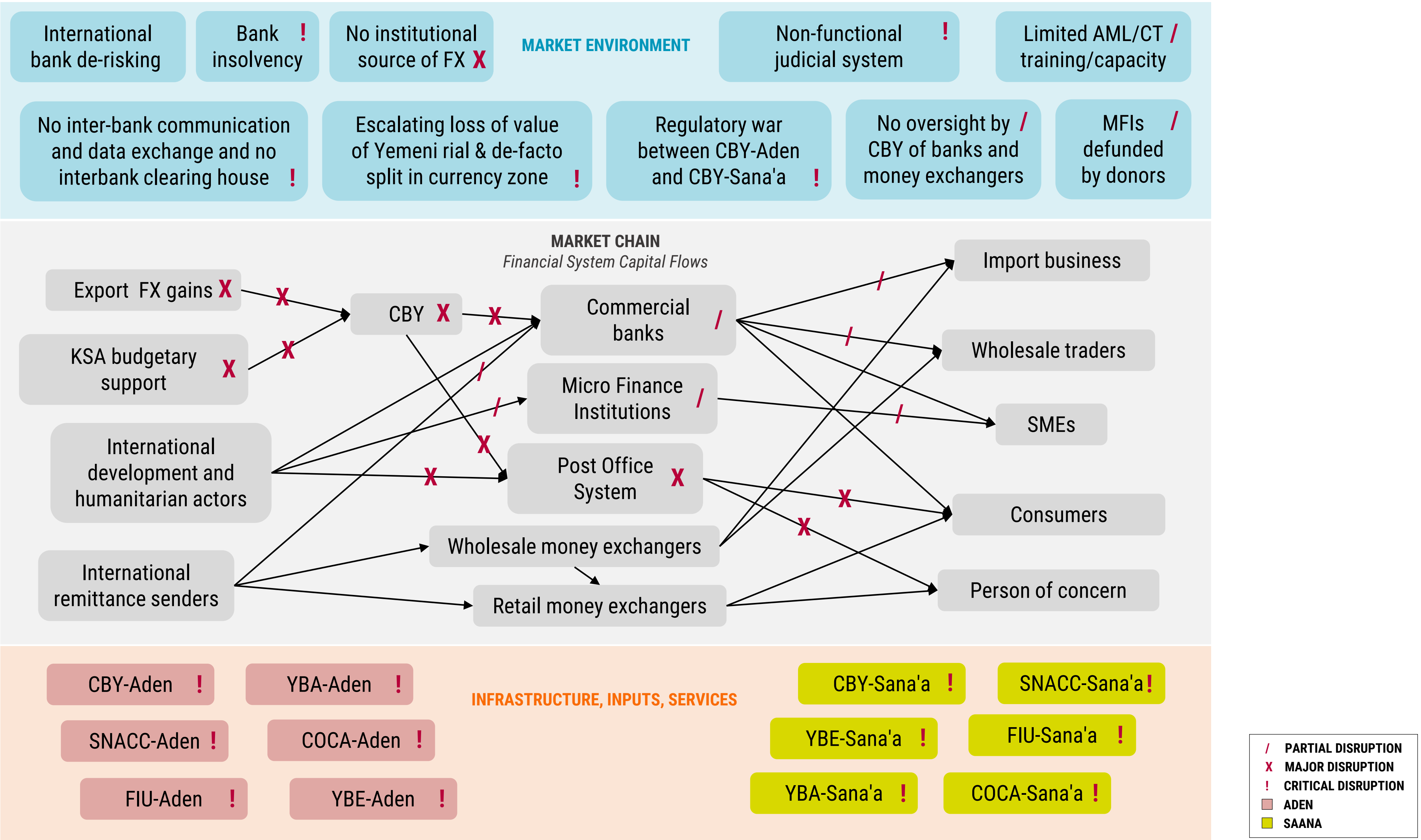
FINANCIAL MARKET SYSTEM ANALYSIS – VISUALISATION

Yemen financial system analysis: pre-conflict



Source: ACAPS/YAT

Yemen financial system analysis: December 2021



Source: ACAPS/YAT

YEMEN'S FINANCIAL ECOSYSTEM

Financial market system analysis

A financial market system is the complex web of businesses, trading structures, and rules that determines how financial services are accessed, exchanged, and transformed in a marketplace (Investopedia accessed 08/12/2021). A financial market system analysis is the process of assessing and understanding a market system's key features and characteristics to enable assessments that identify existing issues and risks and inform projections about how the system will function in the future. This paper uses a market system analysis approach to examine Yemen's financial market system and how it has changed since the start of the conflict.

It does so by examining three components of the financial market system:

- **Financial market actors** buy and sell cash and provide financial services in Yemen. These entities include banks, money exchange companies, and MFIs.
- **Key infrastructure and support services** are actors and services that support the market system's overall functioning or performance, even though they do not directly buy or sell items.
- **The market environment** involves factors that strongly influence how producers, traders, consumers, and other market actors operate. These factors include formal policies, regulations, and rules; informal social norms, such as trust, clients' histories, gender roles, and business practices; trends and current affairs, including social and political conflict patterns; and economic and environmental trends.

Financial market actors

Components of Yemen's financial system include the official financial sector, banks (including commercial, Islamic, and microfinance), the money exchange sector, and MFIs.

Commercial, Islamic, and microfinance banks

The current conflict has worsened the level of fragility, vulnerability, and exclusivity of the formal banking sector that existed prior to the conflict. In particular, the additional de-risking measures that international banks applied against Yemeni banks, followed by the fragmentation of the financial system, have significantly affected many commercial and Islamic banks and, to a lesser extent, microfinance banks. Despite the challenges that the formal banking sector is facing, there are 19 banks currently operating in Yemen (11 commercial banks, four Islamic banks, and four microfinance banks – see Appendix 1: Banks in Yemen).[1] Two state-run banks, the Cooperative and Agricultural Credit Bank (CAC Bank) and the National Bank of Yemen (NBY) – also known as Al-Ahli Bank – have become divided, with competing branches in Aden and Sana'a respectively operating under IRG and DFA supervision.

Three financial service providers (FSPs) received full bank licenses in 2020–2021.[2] Bank branches are in main cities and urban areas, making access to banking services negligible for about 73% of Yemenis living in rural communities. Access to banking services is also uncommon in main cities, as only 6% of Yemeni adults have a bank account. The overall number of Yemenis holding an account fell by almost 40%, from 2.4 million in 2014 to 1.4 million in 2016 (IBS 01/10/2020). This decrease highlights the growing shift from formal electronic cash systems back to traditional cash-based banking approaches. People only generally use e-rial transfers for electricity, internet, and mobile phone bill payments, and typically by more privileged households.

The client base of the Yemeni banking sector is corporate in nature because banks were established to cover both banks' financial sector owners and the private sector. Banks have a limited contribution to the development of the business sector as indicated by the structure of deposits, credit size, and allocation. Bank credit shares to the private sector reached only 6% of the gross domestic product in 2014 (estimated to be at a total of USD 43.23 billion) (Trading Economics accessed 08/12/2021). A CBY estimate shared with the World Bank in January 2000 indicated that less than 80 private business account holders at the time represented, on average, 75% of commercial banks' credit to the private sector (WB 01/2000). According to the 2015 CBY annual report, about 42% of banking sector credit was allocated to import financing, while almost the same percentage of all bank credit portfolios to nongovernment credit were classified as nonperforming loans (Sana'a Center 15/02/2019).

1 There are 11 commercial banks currently operating in Yemen: Arab Bank Limited, CAC Bank, IBY, NBY (Al Ahli Bank), Qatar National Bank, Rafidain Bank, United Bank Limited, Yemen Bank for Reconstruction and Development (YBRD), Yemen Commercial Bank, Yemen Gulf Bank, and Yemen Kuwait Bank (YKB). Two of these commercial banks are public or state-run: the CAC Bank and NBY, while the YBRD is a publicly and privately owned commercial bank. The Housing Bank is another state-run bank, but despite no longer being operational, it has not officially been declared defunct. There are four Islamic banks: Saba Islamic Bank, Shamil Bank of Yemen and Bahrain, Tadhamon Bank, and Yemen Islamic Finance and Investment Bank. There are four microfinance banks: Al-Amal Microfinance Bank, Al-Kuraimi Islamic Microfinance Bank, Al Qutaibi Exchange Company, and Aden Exchange Company.

2 CBY Aden issued Al Qutaibi Exchange Company and Aden Exchange Company licenses to operate as microfinance banks while also retaining their money exchange licenses. Both CBY Aden and CBY Sana'a awarded Al-Kuraimi Islamic bank a full bank license (Institute of Banking Studies 01/10/2020).

A 2010 study by the Yemen Businessmen Club (YBC) found that the Yemeni banking sector's concentration level is extremely high when measured based on an assets criteria (YBC 2010). In 2021, the Ministry of Planning and International Cooperation estimated that three banks (the International Bank of Yemen or IBY, Tadhamon Bank, and CAC Bank) held about 50% of the Yemeni banking system's total assets (MoPIC 05/05/2021).[3] This concentration level suggests a considerably low degree of competition between Yemeni banks, which has likely influenced their efficiency and ability to attract deposits and their lending and financing operations. Similarly, the 2010 YBC report found that each bank was operating in near isolation from the others, given the absence of an interbank market or any joint lending transactions worth noting.

The solvency of several banks worsened during the conflict. Preconflict deposits were largely frozen, and access to funds became limited to small periodical amounts. Banks were prepared to issue checks for cash deposited before the conflict, but recipients would then be faced with the option of exchanging this check for physical cash at a significantly above-market exchange rate (KII 09/11/2021). It is important to note that new cash deposits made post-CBY transfer in September 2016 are accessible without loss.

In recent years, banks have faced multiple challenges, prompting many elite clients to withdraw their cash balances and shift to money exchange networks, where the circulation of most foreign and local currency has transferred. Challenges include, first, the inability of banks to make direct bank-to-bank transfers to certain countries given a lack of liquidity and de-risking. Money exchange networks have helped address these particular constraints – enabling traders to deposit cash in accounts held abroad with transfers conducted through regional networks (and enabling traders to tap into remittance flows to Yemen from key source countries, namely Saudi Arabia and the UAE). Other traders have also previously coordinated the physical transfer of foreign currency from Yemen abroad, often through Oman. Second is the limited ability of CBY Aden to supply FX, with CBY Aden largely restricted to crude oil export revenues. Other key sources of foreign currency, such as remittances and humanitarian funding, were predominantly sent to DFA-controlled territories, where most of the population resides. Third is CBY Sana'a freezing banks' access to treasury bill portfolios and current and reserve account balances. Fourth is the temporarily suspended access to the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network in Yemen. This access was lost during the relocation of the CBY headquarters to Aden but was resumed in 2017 via CBY Aden. Fifth, banks have been suffering from the impacts of rival attempts by CBY Sana'a and CBY Aden to regulate the system, as outlined in more detail in the market environment section below.

Money exchangers

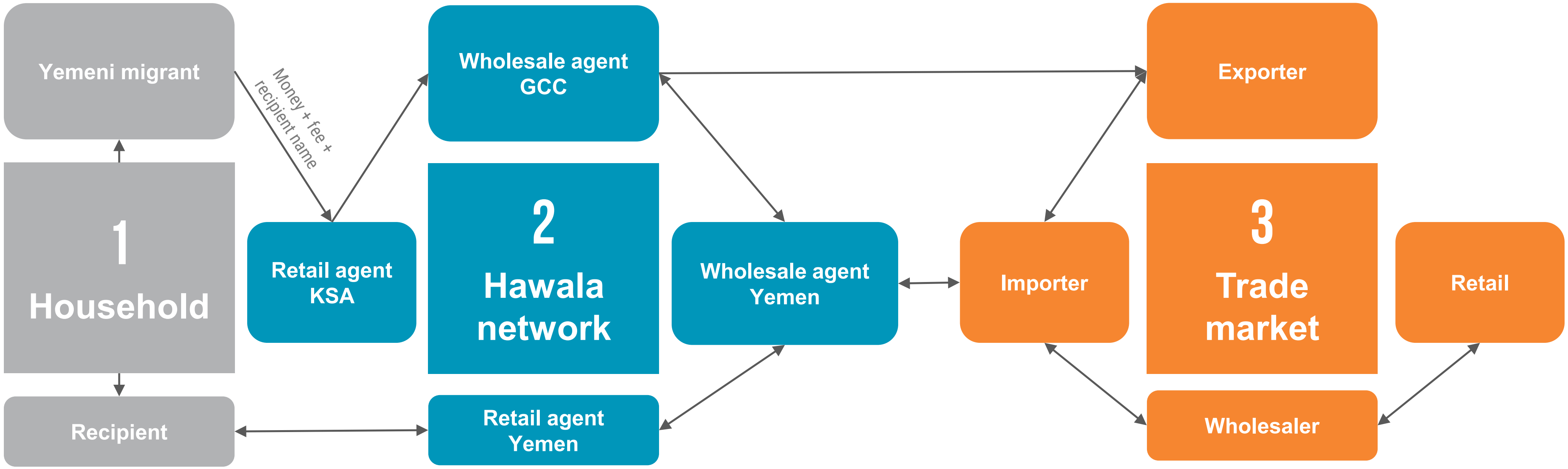
The money exchange sector in Yemen predates the formal banking sector by decades. CBY is the licensing and regulatory authority for money exchangers, with CBY Aden and CBY Sana'a issuing separate licenses and regulations. Some money exchangers do fail to comply with existing regulations. CBY has had limited capacity to regulate and collect data from money exchangers, preventing it from better understanding the money exchange sector dynamics. There is a general sentiment that there is much more data regulation and collection in DFA areas compared to IRG areas (KII 09/11/2021). According to Yemeni law, there are two types of money exchange entities based on the business size: wholesale (large companies) and retail (sole proprietorship shops).

By law, money exchange companies are licensed to sell and purchase foreign currencies and process local and international money transfers. Their core business activity, however, is processing the informal inflows and outflows of import financing and remittance delivery FX transactions that the remittance of migrants funds. Exchangers are efficiently integrated with regional unregulated (hawala) networks.

Money exchangers also control parallel FX market operations, including the sale and purchase of FX at the market rate among money exchange networks and with banks and the trade sector. As such, money exchange organisations are often described as semiformal since they all have licenses but also provide services beyond the scope of what their licenses permit. A detailed breakdown of the informal remittance pathways to Yemen can be found in Appendix 4 of this report.

3 The CAC Bank, being a public institution, is currently largely defunct and split between two entities in the north and south of the country.

Figure 1. Informal remittance pathways to Yemen



Source: ACAPS

Even before the conflict, the money exchange sector already held public deposits illegally. With banks losing their role in trade financing and financial sector roles transferred to the money exchange sector, money exchange companies have accumulated tremendous public savings. This setup is particularly the case in the trade and services sectors, where money exchangers hold physical local and foreign currency while banks struggle with liquidity. Money exchangers efficiently facilitate internal and external personal transfers, import financing, and credit offers (not regulated services), meaning they are currently operating as de-facto banks.

In Yemen, the term 'hawala' is used as a descriptive word for all actors engaging in money exchange and money transfers. There has been a sharp rise in the number of money exchange companies (both licensed and unlicensed) operating in Yemen during the conflict. In 2014, there were 605 licensed and no unlicensed money exchangers. In 2017, the number of money exchange businesses totalled over 1,350, of which 800 were unlicensed (Sana'a Center 06/09/2018). The unlicensed shops are known to operate under the umbrella of larger licensed money exchange companies either informally or as agents.

As noted above, CBY Aden and CBY Sana'a issue separate licenses to money exchange companies. Licenses are awarded to money exchange companies established before the conflict without undue obstruction. In contrast, there are discrepancies in terms of licensing for small exchange shops that only operate in either DFA or IRG areas. For small exchange shops operating in DFA areas, CBY Sana'a issues the license, while CBY Aden issues licenses for small exchange shops operating in IRG areas.

Among the strengths of the money exchange market is a self-regulatory system based on mutual trust, access to market-based supply, and demand for FX and YER. For instance, money exchange networks are the main channel for Yemeni migrants' FX remittance inflows and trade financing outflows, and, domestically, they are the sole local transfer channel and buyer of market foreign currency.

A primary issue constraining demand for formal financial services in Yemen is that 73% of the 33 million-strong population live in rural areas. There, most Yemenis are employed in agriculture and herding and have the highest national poverty and illiteracy levels, with 45% of the population living on less than USD 2 per day (World Bank accessed 08/12/2021). An estimated 50% of the population is illiterate, and 50% do not have national identification documents (although those two groups do not directly overlap) (Bowers 01/2009). As a result, many households in Yemen are unable to engage with the formal banking system – either because of financial constraints or the fact that they do not possess a national identity card or do not have sufficient literacy skills, which limits their ability to decipher account statements, deposit slips, and money transfers.

In 2017, an interagency cash study found that most Yemeni citizens viewed commercial banks as a problem or an unfamiliar option (REACH 18/12/2017). The Yemeni population has access to financial services, as they can use their social networks or money exchange vendors for regulated and unregulated services, as well as MFIs to access financial services. Accessing the money exchange system by simply verbalising a code is simple and removes a strong barrier to engagement with financial services.

The money exchange system enables households across the country to both send and receive money internally and across Yemen's borders. A survey on poverty levels in Yemen by the Central Statistical Organisation and the World Bank estimated that 27% of Yemen's population was regularly receiving remittances from overseas in 2014. This system and other informal business sectors also enable borrowing and purchasing essential items on credit. A 2017 UN-led Emergency Food Security and Nutrition Assessment found that in urban and rural areas, 59% of households were borrowing money or purchasing food on credit to cover their monthly basic needs (FAO 30/06/2017).

Microfinance institutions

As Yemeni banks remained exclusive and unable to contribute to poverty alleviation, donors and international organisations supporting Yemen sponsored a microfinance support programme in 1997 to pilot financial inclusion for the poor in rural Yemen. A government semi-independent fund, the Social Fund for Development (SFD), was authorised to execute and oversee the implementation of a microcredit programme. The civil associations' Law No. 1 of 2001 regulates MFIs, meaning they are not under the authority of the CBY. The preconflict Government of Yemen (GoY) issued Law No. 15 of 2009, assumed to be one of the most supportive microfinance regulations issued in the region. In practice, the microfinance sector has shown limited inclusion success.

Currently, there are eight active MFIs (see Appendix 2: Microfinance Institutions in Yemen), of which only two operate where they are intended (i.e. in rural Yemen). Although microfinance inclusion in Yemen is promising, existing institutions have had limited success because of many critical barriers. Among the main barriers is the MFI model's unsustainability since MFIs are limited to donor funding. The knock-on effect is that MFIs cannot respond to market demand. In practice, the options for offering credit extension are narrowed to groups and activities specified by donor support programming. MFIs also operate outside the CBY regulatory framework, leaving them unequipped to use public savings to design and provide market-based financing products. SFD interaction with donors also heavily influences MFIs, and they remain unable to influence donors' intervention strategies to promote the overall development of the MFI sector.

Throughout the conflict, donors have redirected funding towards the humanitarian sector, leaving MFIs with less support and increased operating costs. The MFI share of the industry dropped from an average of 50% to 40% in terms of borrowers and the value of loan portfolios. Despite the value of loans MFIs appeared to have recovered in 2017 thanks to a World Bank and UNDP recovery programme, the number of borrowers continued to decline during 2018–2019 (Sana'a Center 30/04/2020). At the same time, borrowers find credit repayments to MFIs particularly challenging with the conflict, Yemen's economic crisis, war, and political economy dynamics resulting in displacement, loss of assets, business closures, and increased business costs.

The inability of banks and MFIs to facilitate greater financial inclusion among the poor has presented an opportunity for microfinance banks to fill this gap, in doing so stimulating increased competition in microfinance. Such a potential hasn't materialised in reality, however.

Post office system

Preconflict, the CBY did not regulate the government-run post office system despite it being a depository institution and offering savings and transfer services. It was used to pay out social protection transfers from the social welfare fund and humanitarian cash transfers. The system is currently not functional because of the conflict and is not a significant factor in the Yemeni financial market. As a result, depositors have lost access to their savings account balances, which the post office system had invested in treasury bills.

Key infrastructure and support services

Central Bank of Yemen[4]

As stated in Law No. 14 of 2000, the CBY is an independent authority. It has limited de-facto autonomy, however, to perform monetary policy and financial sector regulatory functions. In practice, the highest priority of CBY monetary policy is to defend the nominal stability of the YER and, to a lesser extent, regulate the financial sector.

In practice, the CBY could be described as a state bank, given that public finance duties account for over 50% of the CBY workload at the highest decision-making and technical levels, including budget revenue and expenditure management, internal and external public debt, and official FX transactions. This setup puts the CBY under public pressure to use public deficit spending on public sector salaries and social services. The case has been particularly problematic during the conflict, with the public holding the CBY accountable for

4 The CBY was created with the merger of the Northern and Southern Central Banks in May 1990 (CBY accessed 22/12/2021).

the delay or nonpayment of public sector salaries. Historically, the CBY usually sacrificed its monetary policy objective of maintaining price stability by extending inflationary credit (i.e. issuing banknotes) to pay public payroll salaries, contributing to price instability.

In theory, the CBY has long managed the YER, a floating currency. Until recently, the CBY played a lead role in maintaining Yemen's fragile economic and monetary stability, which had deteriorated further after the uprising in 2011. The GoY and CBY adopted a monetary policy that used hard currency reserves and coordinated with Yemeni commercial banks to maintain a fixed peg for the exchange rate. From 2010 to March 2016, the bank maintained an exchange rate of YER 215 per USD 1. All parties believed it was critical for the CBY to protect the value of the domestic currency to ensure importers' access to stable FX to import essential commodities from abroad, especially as 90% of the country's food staples, including wheat and rice, have been imported since before the war.

While an informal exchange market has historically existed in Yemen (with remittance traders and other actors wishing to avoid government taxation), instability since 2011 has led to the growing importance and size of the market.

Prior to the conflict, the CBY was the primary actor selling FX to banks for import financing. It was part of a trade value chain in which importers deposited YER in commercial banks in exchange for FX. Banks then deposited YER in the CBY and accessed the required FX. The banks also deposited any further liquidity to the CBY to invest in treasury bills, which paid a high-interest rate. The GoY used the deposited YER to pay salaries, and public sector employees paid the commercial sector for staple food commodities, sustaining the money cycle over time.

During the initial stages of the conflict, FX income from hydrocarbon exports significantly declined and remained below preconflict levels. With the suspension of crude oil exports, Yemen lost its primary source of foreign currency revenue that enabled the CBY to maintain delicate macroeconomic and monetary stability. The CBY tapped into Yemen's foreign currency reserves to tackle the country's growing balance of payments problem and continue to underwrite essential food and fuel imports, maintain exchange rate stability, and make public sector payments. As a result of this emergency action, foreign currency reserves fell from USD 4.7 billion in December 2014 to less than USD 1 billion in September 2016. Before the recent conflict, Saudi Arabia and other Gulf states provided block grants to the CBY to buffer its reserves. Without this kind of support in 2015–2016, the CBY was unable to provide banks with access to FX supplies, as a result stopping banks from depositing YER with the CBY. When the parallel market rate emerged, banks also felt that the increasing inflation rate imposed an additional risk by turning their interest earnings from public debt treasury bills negative. With commercial banks no longer depositing YER with the CBY and the CBY's then reluctance to print new notes, a liquidity crisis developed and left the CBY unable to make social welfare payments and eventually pay government salaries, as they physically lacked the currency to do so.[5]

The situation came to a head on 18 September 2016, when President Abdrabbu Mansour Hadi ordered the relocation of the CBY headquarters from Sana'a to Aden and accused the DFA of mismanaging state funds. As a result, the CBY lost its status as a neutral body that worked in all areas of the country, and the ability of the bank to maintain a monetary policy for the entire country ceased. The DFA refused to recognise the legality of CBY Aden and continued to insist for FSPs to acknowledge the authority of CBY Sana'a. As a result, since 2016, two central banks have been operating in Yemen, with both CBY Aden and CBY Sana'a claiming responsibility and legitimacy for regulating the banking system. CBY Sana'a has the institutional framework and trained staff who had previously undertaken all bank activities, while CBY Aden has the backing of the IRG. This recognition has enabled CBY Aden to directly engage with the International Monetary Fund (IMF), the World Bank, and the SWIFT interbank system. The recognition has also enabled the Aden office to order new currency printed in Russia. In printing new YER banknotes, CBY Aden looked to reduce opportunities for the counterfeiting of local currency owing to concerns over the forging of old YER banknotes that the CBY printed and issued before September 2016. As a result, CBY Aden proceeded to print new YER banknotes with a different shape and colour than the older banknotes. Many different actors saw this as a big mistake, with the perception that it would have been possible to address concerns over the counterfeiting of local currency without changing the colour, shape, and design of the currency. This ill-thought-out change in design has had disastrous consequences, such as leading to the existence of two currencies. The easily identifiable nature of the new notes has also enabled the DFA to prevent the circulation of the new notes in their areas of control.

This split has caused many difficulties, especially with the two authorities working against one another. The DFA in Sana'a prohibits banks from sending periodic financial data to CBY Aden, which is also under pressure from various institutions to provide banking and monetary details. CBY Aden has placed significant pressure on banks to provide the information, as illustrated by events in late 2020 when CBY Aden filed cases against the board of directors and executive managers of three Yemeni banks: the IBY, YKB, and YBRD. The problem for banks in Yemen is that the DFA and CBY Sana'a have warned against sharing financial data with CBY Aden. Banks are subject to punitive measures from the DFA and, in some instances, drastic actions, like abduction and imprisonment by authorities and sometimes the physical closure of banks (Sana'a Center 27/11/2020).

5 Between 2015 and September 2016, the CBY kept issuing banknotes (inflationary financing) not from new shipments but from its stocked reverses of banknotes. While the CBY continued to inject the new banknotes into the market, little were recycled into banks, as banks became useless to the private sector for import FX financing. The money circulation was redirected towards money exchangers and did not flow back to the CBY.

Financial Information Unit

The FIU was established as part of the AML Law No. 35 of 2003 under CBY governance. The FIU was granted more legal independence by Law No. 350 of 2010 and additional amendments made in 2013. It is responsible for receiving and analysing financial information from banks and money exchange companies regarding suspected illegal financial transactions. It carries out its assessments in collaboration with the CBY banking supervision sector. The FIU is also responsible for reporting money laundering cases to the public prosecutor. Before cases are submitted to the public prosecutor, the CBY governor must give their approval for the FIU to proceed.

Preconflict, the FIU did not enjoy its legal autonomy in practice. It operated as part of the CBY banking supervision sector and had to obtain the governor's approval to act (MENA FATF 09/04/2008). It could share information only through the AML Committee and access and request information from FSPs regulated by the CBY (Global Center 03/2015). The FIU is mandated to issue confidential memorandum of understanding agreements for information exchange with the AML international regulatory system and regional and international counterpart institutions.

The unit is critical to boosting the Yemeni financial sector's position within the international financial system. There was progress in improving the unit's technical capacity and abilities to enhance financial sector compliance before the conflict, although political economy dynamics undermined the effectiveness of the FIU. The unit became fragmented during the conflict after the division of the CBY in September 2016. In Sana'a, the FIU fell under DFA control and became an instrument to process measures against anti-DFA business and political elites, including issuing orders to freeze fiscal and financial assets. On the other hand, the IRG-run FIU still struggles with a lack of capacity or access to the banking sector and money exchangers mainly headquartered and remaining in Sana'a.

Central Organization for Control and Auditing (COCA)

The COCA is the national supreme auditing institution, established by Law No. 39 of 1992 as an independent monitoring organisation scrutinising public expenditures. The organisation reports to the president, prime minister, and parliament. Its main aim is to ensure that all public fund revenues and expenditures are effectively and efficiently managed to serve the public interest and national economic development (EUROSAI 2013). Within its scope of work, the COCA has the authority to conduct compliance and performance auditing missions on public banks. Before the conflict, the COCA did not audit CBY accounts since it had no legal mandate to do so (largely because of CBY Law No. 14 of 2000, which granted the CBY full independence).

Since the outset of the conflict, the nature of the COCA and its scope of work have transformed. First, the COCA became fragmented, with an IRG-run COCA operating parallel to its DFA counterpart. Institutional and technical capacities remained with the DFA-run COCA. The parallel IRG-run COCA has limited capacities and oversight over public fund management. The IRG-COCA has been politicised as well; for instance, it conducted an audit of CBY Aden accounts in response to the 2021 UN Panel of Experts report, despite doing so being a direct violation of the CBY's legal independence (UNSC 25/01/2021). Intraconflict between IRG political and elite fractions drove this audit attempt.

Supreme National Anti-Corruption Commission (SNACC)

The Yemen SNACC was established as part of Anti-Corruption Law No. 39 of 2006. Its passage was aimed at boosting public awareness, introducing measures to limit and prevent corruption, and carrying out investigations of suspected corruption. Since the creation of the SNACC, it has remained ineffective in curbing corruption or holding corrupt officials accountable (Sana'a Center 10/11/2018). Since the conflict started, the SNACC has followed the trend of state-run institutions becoming fragmented and divided between the IRG and DFA. The IRG-run SNACC seems to be politicised similar to the COCA. For instance, IRG-SNACC tried to conduct a corruption investigation against CBY Aden management following initial accusations of corruption against senior CBY Aden officials by the UN Panel of Experts in early 2021 (before the accusations were withdrawn). CBY Aden rejected the involvement of the SNACC in accordance with CBY Law No. 14 of 2000. The law stipulates that only the CBY board of directors has the right to assess the performance of the CBY executive management team.

Payments and Foreign Currency Committee

The DFA established the Payments and Foreign Currency Committee in November 2017. The committee quickly became one of the DFA's primary economic regulatory bodies. Its main responsibilities include managing the supply and demand of FX and the local currency in DFA areas. It is instrumental in managing exchange rate stability and a near-enforced exchange rate in DFA areas.

Financial sector associations

The Yemen Banks Association (YBA) and Yemeni Exchangers Association (YEA) were established under the civil organisations' Law No.1 of 2001 (Sana'a Center 27/01/2021). It established these associations to protect the rights and unify the voices of member banks and money exchangers. During the conflict, the functional authority over their physical locations had politicised financial sector associations.

The market environment

Limited financial service innovation during the conflict and amid the COVID-19 pandemic

While electronic financial services provision in Yemen is almost exclusively authorised among banks, in 2020, CBY Sana'a issued a resolution to extend service provision to nonbank financial institutions. Several banks and money exchangers have been piloting (in collaboration with aid organisations) e-rial payments in the cash transfer distribution (IBS 01/10/2020; Salisbury 01/10/2011). In 2020, in response to the fiscal liquidity shortage and ban on new YER banknotes issued by CBY Aden from September 2016 onwards, CBY Sana'a imposed the conversion of the new YER banknotes into electronic currency or e-money (referred to in Yemen as e-rial) through certain service providers. The DFA has tried to use the electronic currency to pay public staff salaries since April 2019. The attempts have failed because the e-rial in Yemen is mainly used for small bill payments, such as water, electricity, internet, and mobile phone credit. A lack of infrastructure and the cash nature of Yemen's economy and society make efforts to make the e-rial a common means of exchange in daily commercial activities a challenge (Sana'a Center 21/01/2020).

Influence of political economy dynamics over banking and regulatory bodies

Yemen's economy largely depended on hydrocarbon (specifically crude oil) exports to gain FX income to finance its heavy and growing reliance on imports, including 90% of staple food, fuel, and medicine needs. This dependence enabled the dominance of elite large businesses on bank ownership and services, including FX financing, import trade, and bank credit. According to the 2004 establishment census by the Central Statistical Organization, there were 300,000 businesses in Yemen, but only 3% were classified as large (employing 25% workers or more). The remaining 97% were medium, small, and micro enterprises (Yemen CSO 2004). According to a 2011 Chatham House report, prior to the conflict, only ten powerful families owned this 3%, and they controlled about 80% of private-sector activities in import trade, banking, transportation, services, and industry. A 2017 Overseas Development Institute report found that even during the conflict, this dominant elite business class has maintained the capacity to adapt to the changing political landscape by integrating into new political patronage networks (ODI 21/02/2017).

Big businesses are the major shareholders of Yemeni banks, which lend money to shareholders, businesses, and well-known clients. The concentration of bank ownership results in a convergence of bank and shareholder interests. As a result, major joint shareholders of both banks and big businesses are the ones making banks' decisions on credit allocation. The 2010 YBC report found that in an Industrial Enterprises Survey of 481 large companies in Yemen, only 47% had a bank account with a commercial bank. Most of these companies had to use their own resources to finance projects or tap into informal networks to raise the required capital, limiting their growth and raising the cost of investment (YBC 2010).

International bank de-risking

As noted in an ACAPS 2021 paper on the impact of remittances on Yemen's economy, since 11 September 2001, Yemeni banks have faced varying degrees of de-risking measures (ACAPS 18/10/2021). Additional de-risking measures were introduced after the conflict escalated in March 2015, making it more difficult for Yemeni banks to connect with foreign banks, especially in the US, the UK, and other European countries where correspondent accounts and banking services were suspended (KII 30/03/2021). Additional de-risking against Yemeni banks in 2015 has made Yemeni banks and their respective clients more dependent on corresponding transactions and banking services provided by Lebanese banks (Sana'a Center 08/05/2020). The onset of the Lebanese financial and banking crises in November 2019 and the subsequent capital controls that led to the freezing of an estimated USD 240 million worth of funds, which Yemeni banks held in correspondent accounts in Lebanon, removed Lebanon as a viable corresponding bank option. Many banks in other countries continue to offer Yemeni banks correspondent banking services, such as those located in Bahrain, China, Jordan, Kuwait, Oman, Qatar, Saudi Arabia, Turkey, and the UAE, among others (KII 19/01/2021; KII 10/03/2021).

Blanket de-risking measures against banks are viewed in Yemen as a contributing factor to the shift of financial flows from banks to money exchange companies. With Yemen's financial cycle moving outside of the formal banking sector and through more informal channels, it has become more difficult to monitor financial transactions to and from Yemen. It has also become more difficult to uphold AML and CFT principles regarding Yemen.

Limited AML and CFT training capacity

There are broad concerns over the compatibility of Yemeni banks and money exchangers with international AML and CFT standards for certain countries in Europe and North America. These concerns predate the current conflict and have shaped the decisions of banks in North America and Europe to apply additional de-risking measures against Yemeni banks, which have been in place over the last ten years (ACAPS 15/10/2021).

The difficulty that individual Yemeni banks face when providing reassurances to external actors over AML and CFT compliance concerns the fact that they are treated collectively rather than individually. The easier, less time-consuming decision for non-Yemeni banks is to limit engagement with all Yemeni banks. There are likely varying degrees of compliance with international AML and CFT standards among different banks. Several Yemeni banks use effective compliance systems (e.g. AML Monitoring System and SWIFT Sanctions Screening) linked to the latest internal Office of Foreign Assets Control (OFAC), Organisation for Economic Co-operation and Development (OECD), and the EU blacklists. Some of these banks hold internationally recognised accreditation that demonstrates adherence to AML and CFT, such as those that hold the Certified AML Specialist certificate. In 2021, the Sana'a-based Yemen Banking Institute provided several training packages on AML and CFT with international accreditation to banks, the CBY, and the FIU. Training alone did not ensure compliance, as other measures and actions taken by the banks were also considered.

An additional issue is the Middle East & North Africa Financial Action Task Force (MENA FATF), an intergovernmental body that evaluates countries for the strength of their AML and CFT regulations. The MENA FAFT has 40 recommendations that countries integrate into their laws, policies, and regulations. To check Yemen's compliance with these procedures, the head of the MENA FATF, with the secretary and other members, would traditionally visit the country and take samples, for instance, from the FIU, the CBY, banks, money exchangers, insurance companies, and other institutions, by requesting certain documents. The last such MENA FATF visit was completed in 2007. As a result, it has been difficult for the CBY, both prewar and currently, to improve perceptions of their AML and CFT compliance, limiting the impact of reform efforts.

Dysfunctional judicial system undermining the financial sector

The dysfunctional judiciary system is one of the main constraints on formal financial sector use as banks have sustained significant losses from the ineffective recourse to recover nonperforming loans. These losses could be the result of stonewalling by the political elite if a case appears to challenge them or the reluctance of security forces to enforce legal decisions that threaten the interests of elite actors (IMF 03/05/2002). There is also a lack of specialised courts and qualified judges for the financial sector, and sharia principles that undermine banks' legal rights heavily influence judges when it comes to reclaiming money owed in the form of accumulated interest on loans (WB 10/2015).[6]

Country split into two areas of control, with a divided economy

Yemen has been split into two areas of control: one in the south and east of the country under IRG control and the other in the north under DFA control. Since 70% of the population is based in DFA areas, most remittances are sent to recipients in northern and northwestern governorates. The northern governorates also share a mutual border and strong historical and social ties with Saudi Arabia. Most Yemenis coming from the northern regions migrated to Saudi Arabia and other Gulf countries in the 1970s and 1980s. As a result, the DFA is in a stronger position to coordinate trade access to remittance inflows and secure requisite foreign currency to facilitate trade and critical imports through the above-mentioned Payments and Foreign Currency Committee.

The DFA-controlled Sana'a city remains the country's capital and economic hub, where Yemen's financial system is heavily concentrated. Most banks and money exchangers (and, by extension, the exchange networks that span the country) are headquartered in Sana'a. As a result, financial actors follow the rules set by the DFA. The concentration of Yemen's population and financial infrastructure in DFA areas explain why most humanitarian aid and funds are allocated and transferred via Sana'a. In terms of the allocation of humanitarian aid, there is a 70/30 split between DFA and IRG areas.

The leverage of CBY Sana'a over Yemeni FSPs from a domestic banking perspective is linked to the decades it has served as the central bank, as well as the data and capacity it has accumulated. CBY Aden's leverage stems from the international recognition it has obtained thanks to its direct association with the IRG. With this leverage, it can deny Yemeni FSPs access to regional and international financial networks. The SWIFT system previously allocated to CBY Sana'a transferred along with the new headquarters in Aden, well illustrating this leverage.

CBY Aden has faced an uphill battle trying to improve its capacity for several reasons, not least the lack of planning that preceded the transfer of the headquarters from Sana'a to Aden. Manually recorded financial data has also remained in Sana'a. Question marks over internal staff capacity have dogged CBY Aden since the transfer in September 2016, including those aimed at CBY Aden's senior management and members of the board of directors. CBY Aden has faced accusations of incompetency and corruption, the mere perception of which has contributed to a lack of confidence in its ability to manage the economy. Following the rapid depreciation of the YER from August 2021 onwards and accompanying price hikes in non-DFA areas, confidence in CBY Aden went to an all-time low. Yemeni FSPs interviewed for this paper called for immediate changes at the CBY Aden senior management and board levels. On 6 December 2021, then-president Hadi announced long-awaited personnel changes to the board of directors and senior management of CBY Aden. These changes coincided with the announcement that the COCA will conduct an audit of CBY Aden covering September 2016 through the end of 2021.

6 Banks provide loans with interest. When debtors default on loan repayments, the bank and debtor end up in court. In Yemen, the judge often decides that the debtor must repay the bank the original loan amount but ignore the amount owed in interest since it is goes against Islamic principles.

The escalating loss of value of Yemeni currency and the de-facto split in the currency

In December 2019, CBY Sana'a extended a ban on newly printed YER banknotes (i.e. those printed and issued by CBY Aden after September 2016). The extended ban prohibited citizens in DFA areas from holding, using, and circulating new YER banknotes. From the DFA perspective, they restricted commerce in DFA areas to old YER banknotes (both old and new notes were allowed in IRG areas) to protect their areas from local currency depreciation and inflation given CBY Aden's massive printing of new YER banknotes. Since 2017, CBY Aden has issued over three trillion worth of new YER banknotes. From an IRG perspective, CBY Aden has the right to print more banknotes as the internationally recognised authority. The ban on new YER banknotes in DFA areas has been consistent, while the amount of old YER banknotes in circulation has continued to decline. Old YER banknote liquidity concerns shape the DFA and CBY Sana'a attempts to promote the e-rial.

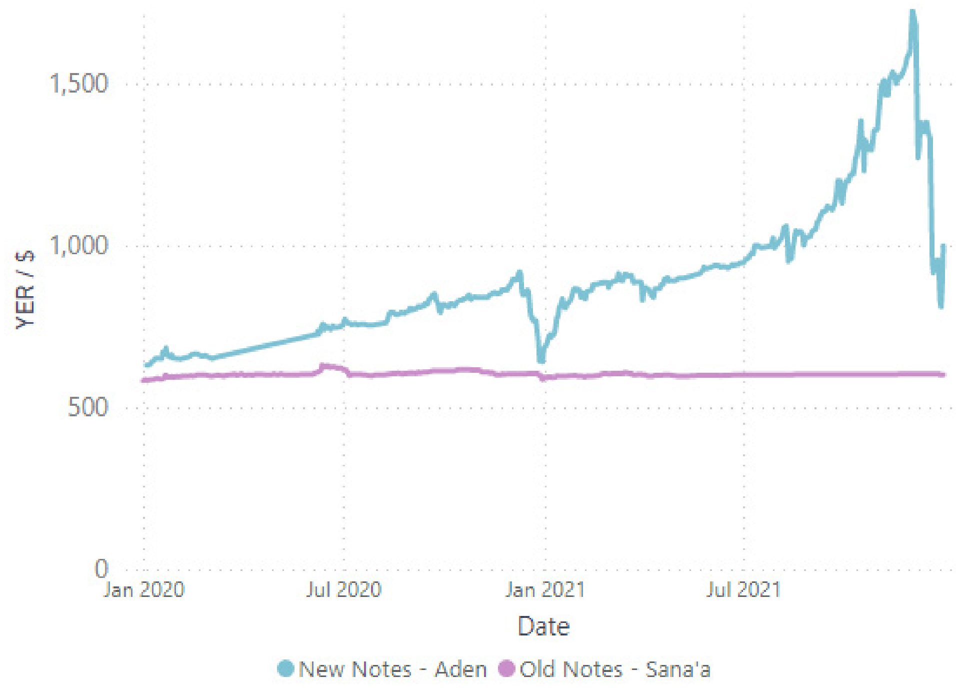
As a result of the finite amount of currency in DFA areas (with an estimated 30% of banknotes in circulation highly damaged), old notes have become relatively more valuable compared to the more abundant new notes, and rates have diverged (Sana'a Center 21/01/2020 and 27/11/2020). The absence of coordination and cooperation between CBY Sana'a and CBY Aden has resulted in the bifurcation of the YER and conflicting orders to banks under their purview. The old and new banknotes have become viewed simply as two different currencies. As can be seen in the table below, there has been a steady decline in the value of the new YER banknotes circulating only in IRG areas. On 20 December 2021, its value was at YER 945 to USD 1, which was much lower than the value of old YER banknotes at YER 603 to USD 1 (ACAPS YETI accessed 22/12/2021).

As mentioned in the November 2021 ACAPS thematic paper on remittances, both remittances and humanitarian funds were concentrated and flowed through the northern DFA areas. This status helped the DFA secure and allocate sufficient foreign currency to meet importers' demands. In sharp contrast, CBY Aden has found it more difficult to access foreign currency circulating in the market among banks and money exchange traders, contributing to difficulties for CBY Aden to maintain exchange rate stability (ACAPS 15/10/2021). Although there is a higher rate of FX flows through DFA areas, the market exchange rate stability in DFA areas is mainly enforced, as opposed to being more in line with FX supply and demand dynamics. CBY Sana'a achieves this enforcement through different regulatory actions:

- controlling the allocation of importers' demand for foreign currency and allocating supply
- controlling the limited supply of old local currency banknotes generated by both actors and state revenue collections
- strict control and application of penalties to perceived violators, including charging and jailing for incompliance with DFA regulations and compliance with CBY Aden, often with the use of DFA-run intelligence forces
- close monitoring and extraction of any new YER banknotes that enter DFA areas.

Without these measures, there would be more noticeable fluctuations in the exchange rate than can currently be observed.

Figure 2. YER/USD exchange rate (January 2020 to December 2021)



Source: ACAPS YETI (accessed 22/12/2021)

Regulatory war between CBY Aden and CBY Sana'a and connected regulatory and civil society bodies

Currently, the most significant issue in Yemen is the regulatory war between CBY Aden and CBY Sana'a, which are issuing contradictory instructions to banks and punishing them for fulfilling their competitor's instructions.

Following the transfer of the CBY headquarters in September 2016, regulatory warfare escalated in November 2017 when the Payments and Foreign Currency Committee was established in Sana'a. In late October 2018, CBY Sana'a issued a circular to banks instructing them not to deposit cash with CBY Aden as they sought to obtain USD from the Saudi deposit. In January 2019, CBY Aden began requiring banks to provide their data and started applying penalties against banks that did not comply. At the same time, CBY Sana'a warned senior bank officials of imprisonment if the banks provided data to CBY Aden.

The situation placed the banks in a difficult position between two competing regulatory authorities. In December 2019, the DFA extended the ban on the use of newly printed banknotes (those issued by CBY Aden after September 2016).

The DFA then attempted to solve the YER liquidity crisis by issuing electronic money. CBY Sana'a issued a circular in March 2020, giving the green light for nonbanks to start issuing electronic money and offering electronic money services. In response, CBY Aden issued a circular to banks and money exchange companies warning them not to adhere with regulations issued by CBY Sana'a. It also restricted the issuance of electronic money to banks according to Circular No. 11 of 2014. In October 2020, CBY Aden filed cases against the senior management (including the board of directors) of three Yemeni banks with the public prosecutor in Aden. Over 12 months later, CBY Aden sent a letter to a correspondent bank of the IBY asking them to stop dealing with the IBY, an action that represented a serious escalation. Since the change in management at the CBY in December 2021 there have been no further major incidents of this nature.

The main issue is that both CBY Aden and CBY Sana'a are making competing demands of FSPs, acting like they are the sole legal authority and have the authority to govern the financial sector and implement their respective monetary policies. Each side wants to show its power, and both can use their authority to implement monetary policies and manage the financial sector and the exchange rate.

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APPENDIX 1: BANKS IN YEMEN

	NAME	OWNERSHIP	TYPE	HQ	COUNTRY OF ORIGIN	NUMBER OF BRANCHES
1	Arab Bank Limited	Foreign	Commercial	Sana'a	Jordan	9
2	Cooperative and Agricultural Credit Bank	Public	Commercial	Sana'a	Yemen	51
3	International Bank of Yemen	Local private	Commercial	Sana'a	Yemen	23
4	National Bank of Yemen (Al Ahli Bank)	Public	Commercial	Aden	Yemen	27
6	Rafidain Bank	Foreign	Commercial	Sana'a	Iraq	1
7	United Bank Limited	Foreign	Commercial	Sana'a	Pakistan	3
8	Yemen Bank for Reconstruction and Development	Mixed public and local private	Commercial	Sana'a	Yemen	44
9	Yemen Gulf Bank	Local private	Commercial	Sana'a	Yemen	2
10	Yemen Kuwait Bank	Local private	Commercial	Sana'a	Yemen	12
11	Saba Islamic Bank	Local private	Islamic	Sana'a	Yemen	16
12	Shamil Bank of Yemen and Bahrain	Local private	Islamic	Sana'a	Yemen	9
13	Tadhamon International Islamic Bank	Local private	Islamic	Sana'a	Yemen	21
14	Yemen Islamic Bank for Finance and Investment	Local private	Islamic	Sana'a	Yemen	5
15	Al Amal Microfinance Bank	Mixed public and private	Microfinance	Sana'a	Yemen	18
16	Al Kuraimi Islamic Microfinance Bank	Local private	Microfinance	Sana'a	Yemen	23
17	Al Qutaibi Exchange	Local private	Microfinance	Aden	Yemen	No data
18	Aden Exchange Company	Local private	Microfinance	Aden	Yemen	No data

Notes: CAC Bank and the NBY (Al Ahli Bank) are divided between the DFA and IRG, with separate senior management teams operating in Aden and Sana'a.

Source: ACAPS/YAT using data from CBY Annual report 2013

APPENDIX 2: MICROFINANCE INSTITUTIONS IN YEMEN

	NAME OF MFI	LICENSE TYPE	COVERAGE OF GOVERNORATE	NUMBER OF BRANCHES
1	Aden Microfinance Foundation	NGO	3	8
2	Al-Aweel Microfinance Company	Company	1	5
3	Azal Islamic Microfinance Program	Programme	4	7
4	Hadramawt Microfinance Program	Programme	1	1
5	Nama'a Microfinance Foundation	NGO	5	13
6	National Microfinance Foundation	NGO	10	17
7	Tadhamon Microfinance	Bank unit	9	16
8	Union Microfinance Program – Abyan	Programme	3	6

Source: ACAPS/YAT using data from Sana'a Center 30/04/2020

APPENDIX 3: PROMINENT MONEY EXCHANGE COMPANIES

	NAME OF MONEY EXCHANGE COMPANY	HEADQUARTERS
1	Aden Exchange Company	Aden
2	Ahmed Al-Ameri Exchange and Transfers	Sana'a
3	Al-Akwaa Exchange	Sana'a
4	Al-Busairi Exchange Company	Hadramawt
5	Al-Hitar Exchange Company	Sana'a
6	Al-Jazeera Bros. Exchange Co.	Sana'a
7	Al-Khader Exchange (also known as Mohsen al-Khader Company for Exchange)	Marib
8	Al-Morisi Exchange Company	Ad Dali
9	Al-Nasser Exchange Company	Taiz
10	Al-Noaman Exchange Company	Sana'a
11	Al-Omqy & Bros. Money Exchange	Hadramawt
12	Al-Qutaibi Exchange Company	Aden
13	Al-Thour Exchange	Al Mahrah
14	Al-Yabani Money Exchange & Transfer Company	Sana'a
15	Bin Dowal Exchange Co.	Hadramawt
16	Swaid & Sons Exchange Company	Sana'a

Source: ACAPS/YAT 22/12/2021

APPENDIX 4: INFORMAL REMITTANCE PATHWAYS TO YEMEN

Migrant (remitter)

- A Yemeni migrant hands to the hawala retail agent the remittance amount plus transfer fees (both in physical cash) and provides the name of the recipient in Yemen. The migrant decides which hawala agent to use based on different factors, such as the agent's reputation, location, service fees, and the recipient's access to the payout agent in Yemen. While the migrant does not receive an official receipt, they do receive a transfer code and the name of the delivering network in Yemen.
- The migrant calls their family in Yemen with the remittance details – i.e. amount, code, and delivering network – and will later call back to confirm that the family received the full remittance amount as paid via the hawala agent.
- Migrants that have returned to Yemen are known to sell their personal holdings of FX currencies to hawala agents in Yemen, providing a partial FX cover for hawala agents to pay out other incoming migrant remittances. Traders also supply hawala networks with FX, contributing to the remittance payout to the recipient in the same currency that the remitter sent.

Recipient

After the migrant communicates the remittance details to the recipient's family member or relative, the recipient travels to the closest agent of the specified hawala network. The recipient takes with them their national identification card and the remittance code to receive the total remittance amount in its original currency – e.g. Saudi riyal (SAR) in physical cash – unless they decide to exchange it for YER at the market exchange rate. Doing so enhances the hawala agent's ability to pay out other remittances in SAR.

Hawala agents

The informal remittance process occurring via hawala networks is an extremely competitive and efficient market. For hawala networks to preserve their reputation and market share, integration within the framework is largely limited to kinship and based on trust and confidence.

- As the retail hawala agent in Saudi Arabia receives the remittance amount and fees from a Yemeni migrant, the hawala agent then notifies the wholesale agent located or active in the main cities in Saudi Arabia. The hawala agent provides the wholesale agent with the remittance details (i.e. the recipient's full name, the full remittance amount, and the delivery location in Yemen). The Saudi wholesale agent then processes the cross-border transfer with the wholesale hawala agent in Yemen. The main hawala agent in Yemen records the transaction and generates the code and name of the hawala network. They then submit this information to the wholesale agent in Saudi Arabia, who then shares it with the retail agent in Saudi Arabia.
- Upon the receipt of remittance details, the retail hawala agent in Yemen disburses the remittance in the same currency or in YER based on the recipient's preference without any deduction to the remittance amount.
- Retail hawala agents in Saudi Arabia and Yemen are the focal points for the delivery of remittances and physical currency arrangements. For instance, the retail hawala agents in Saudi Arabia accumulate SAR (in cash) and transport it to the wholesalers for import or trade financing purposes. In Yemen, traders deposit their sale turnover into accounts with the hawala agents to then buy FX and make transfers to facilitate import financing.
- Whenever an importer in Yemen needs to renew their commercial stock, they make a deal for an import financing transfer that includes both buying FX and the transfer of funds abroad. The hawala agent in Yemen processes the transaction as per the agreed rate and fees with their agent in Saudi Arabia.

Traders

- Importers (and their subset chain actors) provide the money exchanger or hawala agent with physical YER banknotes for their daily sale and purchase of FX in the local market and remittance payout if recipients request to receive YER.
- At the same time, importers accelerate the use of the accumulated FX supply in Saudi Arabia from migrants' remittances for import financing as fast as possible to avoid possible seizure from security authorities.
- Import financing through hawala networks provides the trade or import sector with immediate and lower-cost FX.
- Hawala agents in Yemen facilitate import financing by processing transactions, but the physical FX is essentially managed in the remittance source country.

Settlements

There are multiple ways for hawala agents to clear out cross-border transactions, including:

- Electronic accounting and settlement systems in Yemen, as the same families in the Yemeni and Saudi markets, own the main local and regional hawala networks. Based on the codes, the incoming remittances are recorded in the local hawala network system as debt, while outgoing trade financing transactions are recorded as credit. The net is calculated afterwards.
- The net credit due for hawala agents in Yemen could be transported via smuggling mechanisms into Yemen, while the net debt due for local hawala agents in Yemen might be paid through external bank accounts held abroad by Yemeni importers.

There may also be designated clearing houses in regional financial hubs like Dubai.