ECONOMIC PERSPECTIVES

SEPTEMBER 2004

THE GLOBAL WAR ON TERRORIST FINANCE

U.S. DEPARTMENT OF STATE / BUREAU OF INTERNATIONAL INFORMATION PROGRAMS

ABOUT THIS ISSUE

A key element of terrorist networks that was largely undisturbed prior to 9/11 is the global financial infrastructure that facilitates the rise of groups such as al-Qaida and funds attacks against the United States and our global partners.

The work to track and shut down the financial network of terror is one of the most critical efforts facing us today, and we have achieved important successes in the mission to bankrupt the financial underpinnings of terrorism. Raising and moving money is now harder, costlier, and riskier for al-Qaida and like-minded terrorist groups. We have frozen and seized terrorist assets, exposed and dismantled known channels of funding, deterred donors, arrested key facilitators, and built higher hurdles in the international financial system to prevent abuse by terrorists.

Freedom-loving people around the world are targeted by the scourge of terrorism. From the railway bombings of Madrid and Moscow to the commercial center attacks in Istanbul and Casablanca, we have seen that terrorism does not discriminate among race, religion, and national origin.

A robust international coalition is currently working to combat terrorist financing and to focus the world's attention on previously unregulated, high-risk sectors such as charities and hawalas. We have begun to focus our collective attention on our growing concern about the use of cash couriers by terrorists groups. In these efforts, we have enlisted the private sector worldwide — banks, money service businesses, broker-dealers, and the charitable community — to serve as the frontline in this battle. These efforts are contributing to our success.

The drumbeat to disrupt and dismantle terrorist financing has been constant and will continue. We will not relent in our mission to root out and halt terrorist financiers. This issue of *Economic Perspectives* demonstrates how the United States and its allies around the world continue to use all of our authorities, relationships, and expertise to attack sources, conduits, and proceeds of the underwriters of terror.

John Snow
U.S. Secretary of the Treasury

ECONOMIC PERSPECTIVES

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Editor, Economic Perspectives
IIP/T/ES
U.S. Department of State
301 4th St. S.W.
Washington, D.C. 20547
United States of America
E-mail: ejecon@state.gov

BANKRUPTING TERRORISTS

Juan Carlos Zarate

The campaign to keep money out of the hands of terrorists has become a centerpiece of the overall war against terrorism. Using a targeted approach, the United States and its partners worldwide have pooled their law enforcement, intelligence, and economic powers to isolate and disrupt the financial infrastructure of terrorist networks. The benefits are multi-pronged. The sharing of financial information helps unearth terrorist cells and networks while the freezing of assets and other economic sanctions incapacitates terrorists' ability to carry out attacks, maintain their alliances, create infrastructures around the world, and develop deadly weapons. The results to date are encouraging and, over the long term, promise to strengthen the ability of countries to protect the international financial system against abuse by terrorist groups and their supporters.

Juan Carlos Zarate is assistant secretary of the Treasury for terrorist financing. He is responsible for formulating and coordinating the Treasury Department's counterterrorist financing and anti-money laundering efforts. He manages policy guidance and oversight of the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC), and policy guidance for the Internal Revenue Service-Criminal Investigation Division.

When al-Qaida operatives simultaneously attacked New York and Washington with unprecedented devastation on September 11, 2001, the U.S. and global perception of the threat posed by terrorism was forever altered. Today, just past the three-year anniversary of that day, the world continues to face an evolving Islamist extremist terrorist threat of potentially catastrophic proportions. To counter this long-term scourge effectively, we must build upon the successes we have achieved to help bankrupt terrorism.

This is especially true in our diplomatic engagements, which are crucial to building international cooperation in the war on terror. As we have seen in attacks since 9/11, the threat of terrorism is not just an American problem, but one that affects our partners worldwide. It is essential, therefore, that we maintain global attention and political will to attack the ever-evolving threats posed by the movements of tainted capital, as well as to deter and dissuade supporters of terrorist groups.

THE MONEY TRAIL

Focusing on and attacking terrorist money flows is important for several reasons. Financial records and audits provide blueprints to the architecture of terrorist organizations. By following the money trail through financial information sharing worldwide, we can save lives by unearthing terrorist cells and networks. The maintenance of terrorist networks and the acquisition and development of lethal weapons is expensive — even if a particular attack does not prove costly in isolation. Identifying and isolating the sources of funding for terrorist groups incapacitates not only their execution of attacks, but also their ability to maintain international alliances, create infrastructures around the world for recruitment and training, and purchase or develop deadly weapons.

What we know is that global networks of terrorist groups like al-Qaida and Hamas have used a variety of means to raise and move money. They have taken advantage of charities, front companies, deep-pocket donors, and crime of all types to raise money. They have relied on banks, informal remittance networks known as hawalas, wire remitters, currency exchangers, and couriers to move money or value across national borders.

A Global Undertaking

The campaign against terrorist financing — born in part from the lessons of the war against international organized crime and money laundering — has become a centerpiece of our global effort to address the short- and long-term challenges posed by terrorism. In the simplest terms, our targeted approach focuses on attacking terrorist networks by using intelligence, law enforcement, and economic powers to identify and disrupt the financial substructure of terrorist groups. In the long term, our systemic approach broadens and deepens the legal, financial, and regulatory infrastructure and capacity of countries around the world to better secure the international financial system against abuse by terrorist groups and their supporters. These efforts have proven revolutionary in the preventive and proactive use of all elements of national power to stop terrorist financing.

There has been important success to date. We have made it harder and costlier for al-Qaida and other terrorist groups to move money around the world and have built more stringent barriers in the international financial system to prevent its abuse. The success has resulted in part from important international engagement and cooperation. International understanding, collaboration, and capability are clearly necessary in this effort given the global nature of both the financial system and terrorism.

Within weeks of 9/11, the world community committed to fight terrorist financing at several levels, including the timely freezing of terrorist-suspected assets, the arrest of those implicated in providing financial support to terrorist cells, and the international commitment to long-term legal and structural reforms to ensure the integrity of the international financial system. This was reflected in the important adoption of U.N. Security Council Resolution 1373 and the eight Special Recommendations on Terrorist Financing by the 33-member Financial Action Task Force (FATF) on money laundering. Other international bodies and regional organizations, like the International Monetary Fund, the World Bank, the G7 (Group of Seven), G8 (Group of Eight) and G20 (Group of 20), and APEC (Asia Pacific Economic Cooperation forum), also played key roles in marshaling political will and addressing deficiencies in national systems to combat terrorism. The Egmont Group of Financial Intelligence Units, now numbering nearly 100 around the world, focused financial information sharing on terrorist financing.

The Designation Process at Work

A crucial and public component of our approach has been the application of targeted economic sanctions against terrorists and their financiers. When President Bush signed Executive Order 13224 on September 24, 2001, he called upon the secretary of the Treasury, as well as the secretary of state in certain instances, to "designate" terrorists, their financiers, and facilitators. These designations financially isolate entities by blocking or freezing their U.S. property interests and assets, as well as preventing their use of the formal dollar-clearing financial system. The designations also prohibit U.S. persons from doing business or engaging in transactions with such designees. To date 383 individuals and entities have been designated under this power, and well over $140 million in terrorist-related assets have been frozen internationally.

In addition to financially isolating designees by "arresting" their access to the financial system, the designations often serve to deter like-minded supporters from continuing to facilitate terrorist financing as well as to prompt action — of varying kinds — by host jurisdictions. Designation under E.O. 13224 does not necessarily mean that criminal or civil laws have been violated; rather, it suggests, based upon a reasonable basis to believe, a suspected financial or otherwise supportive relationship between the designee and individual terrorists, terrorist organizations, or terrorist activity. When used aggressively, this is an inherently preventive tool implemented to ensure that assets of the supporters or associates of al-Qaida and other terrorist groups are not used to fuel terror. Though there have been challenges to such designations, all of them have been upheld by U.S. federal courts.

Since 9/11, we have harnessed the international community to drive this issue. The U.N. Security

Council has adopted a series of resolutions requiring member states to apply targeted financial sanctions against individuals and financial interests connected to terrorist groups or activity while the European Union adopted a directive on December 27, 2001, allowing it to develop its own list of terrorist-related entities whose assets are subject to blocking by member countries. In October 2003, the FATF issued specific interpretive guidance to terrorist-related asset-freezing obligations of jurisdictions. Many countries, such as Italy and Saudi Arabia, have notified the United Nations, jointly with the United States or unilaterally, in proposing terrorist financing designations to the Security Council. These international efforts to apply financial sanctions to a broad range of terrorist-related targets represent a fundamental component of the global campaign against terrorist financing.

The International Financial System

Over the longer term, our terrorist financing strategy calls for a systemic approach to enhance the transparency and accountability of the international financial system. At home, we are advancing these interests through implementation of the USA PATRIOT Act. Treasury has issued regulations that strengthen existing customer identification, recordkeeping, reporting, and information-sharing obligations in various financial sectors and expand these obligations to new financial sectors such as money service businesses, which are vulnerable to abuse. We are also promoting these systemic interests internationally through the work of the FATF, the FATF-style regional bodies, the International Monetary Fund (IMF) and World Bank, and other multilateral organizations.

We have enhanced those efforts with aggressive outreach to the financial community and the charitable sector. We have challenged these important front-line elements to take more proactive steps to build transparency and accountability, as well as better practices and due diligence, to help ensure they are not being abused by terrorists or criminals.

Better practices across the international financial system have raised higher institutional hurdles for terrorists to circumvent. However, as we strengthen our systemic defenses, terrorists and other criminals will resort to other, less formal mechanisms to raise, store, and move their money. Driving terrorists to move their wealth in less formal or agile ways heightens their risk of detection, but such changes require that we be flexible to adapt to the changing face of terrorist financing.

Moving Forward

To that end, President Bush and Treasury Secretary John Snow recently announced the creation of a new office in the Treasury to bolster our long-term efforts to cut the financial ties of terrorists and better safeguard the U.S. financial system against criminal activity.

The Office of Terrorism and Financial Intelligence (TFI) consolidates the policy, enforcement, regulatory, international, and analytical functions of the Treasury and adds to them critical intelligence components. This change will allow us to better develop and target our intelligence analysis and financial data — such as bank secrecy data — so that we can detect how terrorists are exploiting financial systems and design methods to stop them. It will also allow us to implement our sanctions and regulatory enforcement programs more effectively and to work closely with embassies and the private sector around the world to strengthen the international coalition against terrorist financing.

Indeed, sustained global cooperation and support is the surest path to success as we drain the money supply that terrorists need to stay in business. ■

INTERNATIONALIZING THE FIGHT

E. Anthony Wayne

Terrorists move money through channels as diverse as major banks, charities, and alternative remittance systems. U.N. member states are obligated to apply sanctions against designated terrorists and their financial supporters, including freezing assets, banning travel, and enforcing arms embargos. However, gaps in enforcing sanctions exist, and the United States and its international partners are working to address how to deal with informal financial systems and non-governmental organizations through which terrorists collect and move their funds. The United States is providing substantial assistance to other governments to help them attain the technical ability and skills to clamp down on terrorist financing activity.

E. Anthony Wayne is assistant secretary of state for economic and business affairs. A career foreign service officer, he chairs a large interagency group, the Coalition Building Group, which coordinates plans and actions on terrorist finance with other countries and multilateral organizations. In addition to terrorist finance, his responsibilities include international development, energy, trade policy, telecommunications, and transportation.

The international community is engaged in a long-term campaign against terrorism. One of the critical fronts in this fight is the effort to disrupt the financial networks that sustain terrorist organizations and finance their operations.

This article examines how the U.S. government is organized to fight terrorist financing, what the international community is doing, and what challenges lie ahead as terrorist organizations find new ways to raise and transfer money.

The main development in 2004 has been the genuine internationalization of the effort to stop flows of money to terrorists. For example, Italy proposed more candidates for U.N. sanctions than any other country, followed by the United States, Algeria, Saudi Arabia, and Germany. The European Union issued a major counterterrorism declaration on March 25, 2004, including very specific commitments on counterterrorist finance. In mid-2004, Saudi Arabia placed all overseas charities headquartered in Saudi Arabia under a government-controlled umbrella organization. This action effectively closed the overseas branch offices of the Al-Haramain Foundation, a major international charity, several branches of which had provided support for al-Qaida. The decision also enabled Saudi government control of transactions between Saudi charities and their overseas affiliates. This action should plug a number of conduits for terrorist financing and provides an example of close coordination among responsible nations working together to combat the financing of terrorism.

THE U.S. EFFORT

The tools to combat terrorist finance include intelligence, law enforcement, designation and asset freeze, and various

diplomatic initiatives. These tools are often mutually reinforcing.

One of the most important aspects of the U.S. effort is the public designation of terrorists and their supporters and the freezing of their assets. So far, the United States has designated some 384 individuals and entities.

Legal authority to freeze assets is contained in Executive Order 13224, signed September 23, 2001, deriving authority from the International Emergency Economic Powers Act and the United Nations Participation Act. The Executive Order, available at www.state.gov/e/eb, enables the executive branch to freeze assets administratively and permits quick, flexible, and extensive action.

Equally important is a coordinated interagency process led by the National Security Council. It includes the departments of State, Treasury, Justice, Homeland Security, and Defense, as well as intelligence and enforcement agencies. Indeed, our interagency approach could well be a model for other countries and regional entities looking to restructure their counterterrorism efforts.

The process begins with analysis of money transfers by suspected terrorists and their financial backers. Targets for action are developed. The interagency group meets to examine alternative options to disrupt these networks. Actions could include:

• the Department of the Treasury designating an individual or group, freezing the assets located in the United States or in overseas branches of U.S. corporations or under the control of U.S. persons worldwide, and barring any transactions with U.S. persons or corporations

• the Department of Justice or Federal Bureau of Investigation (FBI) initiating an investigation and, possibly, prosecution

• the Department of State developing a strategy to win international support for our action, for example, by seeking U.N. sanctions

THE UNITED NATIONS

The United Nations has stepped up its efforts to fight terrorist financing. It requires all countries:

• to prevent and suppress the financing of terrorist acts (including U.N. Security Council Resolution 1373)

• to freeze the assets of individuals and entities linked to Usama bin Laden, the Taliban, or al-Qaida (UNSCR 1267 and subsequent relevant resolutions, most recently, UNSCR 1526)

The United Nations has established a process for reviewing requests from member states to add the names of individuals and entities subject to asset freezes to a consolidated list maintained by its 1267 Sanctions Committee. U.N. member states are obligated to take certain measures against these names, including asset freeze, arms embargo, and travel ban.

So far, the international community has frozen approximately $142 million in assets from individuals and entities on the consolidated list. The U.N. mechanism is proving invaluable in internationalizing asset freezes and underscoring the global commitment against terrorism. This is a U.N. list, and imposing specified sanctions against the listed individuals and entities is an obligation of all U.N. members.

It is important to point out that cooperation in designating individuals and entities is a truly global endeavor. Many countries, including Saudi Arabia, Algeria, France, Spain, Italy, Belgium, Germany, the United Kingdom, China, and Russia, continue to submit al-Qaida-linked names to the Sanctions Committee to be added to its consolidated list. Let me give two examples:

U.S.-Saudi Joint Designations: In March 2002, the United States and Saudi Arabia jointly requested the U.N. 1267 Sanctions Committee to add the names of the Somalia and Bosnia-Herzegovina branches of al-Haramain to its consolidated list. These two branches, now closed, were linked to al-Qaida. Subsequently, and as a result of joint U.S.-Saudi referrals, the name of Wa'el Hamza Julaidan, an associate of Usama bin Laden, was added to the consolidated list in late 2002, and nine additional branches of al-Haramain were added in 2004.

Jemaah Islamiya: In October 2002, 50 countries, including all the members of the Association of Southeast Asians Nations (ASEAN) and the European Union, joined together in submitting the name of Jemaah Islamiya to the 1267 Committee. Jemaah Islamiya is

responsible for perpetrating a number of deadly attacks, including on a Bali nightclub.

Laws, Regulations, And Standards

Since 9/11, more than 80 countries have adopted new laws and regulations to fight terrorist financing or are in the process of doing so. The number of Financial Intelligence Units that have met the internationally agreed standards and are able to share information through membership of the Egmont Group (countries with operational financial intelligence units) increased from 69 to 84 members. We have worked closely with the Financial Action Task Force (FATF) on money laundering and its associate regional bodies in this effort.

FATF, an intergovernmental body of 33 countries, has expanded its mandate to include terrorist financing. In addition to its 40 original recommendations on money laundering, FATF has generated eight Special Recommendations on Terrorist Financing that have become the international operational standard on addressing terrorist financing. These recommendations provide a blueprint for countries that need to modify their laws and financial systems to comport with international standards. FATF's ability to publicly list countries with poor anti-money laundering practices encourages countries to put in place stronger money laundering regimes. As a result of this publicity, Nigeria, Ukraine, and the Philippines moved to implement vastly improved legal systems.

Countries have also worked to ensure that terrorists are unable to misuse charities or alternative remittance systems, also known as "hawalas," and money service businesses. Until 9/11, the hawala system was completely unregulated in many jurisdictions. While most hawala transactions are legitimate remittances to families by expatriate workers, terrorists have also used the informal remittance sector.

The Central Bank of the United Arab Emirates (UAE) hosted an international conference in May 2002 where nearly 40 countries recognized for the first time the need to regulate the hawala sector. A second international conference on hawala was held in the UAE in April 2004 to acknowledge and reaffirm the important achievements of the first conference and to establish a plan for continued work. A number of countries, including the UAE and Pakistan, have taken steps to regulate the informal sector, and we are encouraged by initial signs of an increase in the use of banking channels to transfer workers' remittances from the Gulf and elsewhere to their families in South Asia. We will continue to work actively to establish greater levels of transparency and accountability for the informal sector.

Countries around the world have also addressed terrorists' raising and moving funds by masquerading their activities as charitable causes. Hamas fundraising, to take one example, is known to blend funds for both charitable and militant uses. Two very recent examples of countries' actions are European Union countries' designation of Hamas for asset freeze, and, as noted earlier, Saudi Arabia's umbrella organization to supervise all international charities and all overseas transactions by charities.

Capacity Building

Many countries do not have the technical ability and skills to take the actions required of them. The U.S. government has engaged in important capacity-building initiatives with other governments to clamp down on terrorist financing activity. The State Department has obligated more than $11.5 million for counterterrorist finance assistance since 2002. We have prioritized countries needing assistance and shaped programs based on this prioritization. The FATF, G8 (Group of Eight industrialized countries), United Nations Committee on Counterterrorism (CTC), International Monetary Fund, and World Bank are also pursuing and coordinating with us on efforts in this area.

In this context, I want to stress that our embassies around the world have been essential in helping to develop and implement all elements of this global strategy. This input is invaluable as we craft objectives and we implement efforts to build our coalition and take effective actions.

Results and Next Steps

Working with countries around the world, we have made it more difficult for terrorists to collect and move funds. The European Union has designated for asset-freezing almost all the names designated by the United States

under E.O. 13224. At the June 2004 U.S.-EU summit, the European Union committed to work actively with the United States to strengthen efforts against terrorist financing. In the Middle East, South Asia, Latin America, and East Asia, states are working to deprive terrorists of their ability to raise funds in the region.

We have much work cut out for us, however. Terrorist financing appears to be more decentralized than previously, with money often sourced from charities, alternative remittance systems, and even crime, and the money is often transported by courier. In the area of training and technical assistance, international needs remain great.

Given that money is making its way into the hands of terrorists around the world, the only way we will be successful in drying up their financial resources is through continued, active international engagement with countries around the globe. These efforts are succeeding, and they will continue to do so. ■

BUILDING A COUNTERTERRORIST FINANCE REGIME

Celina Realuyo

The U.S. government helps foreign allies build their capacity to prevent terrorists from using the international financial system to further their plots. The interagency Terrorist Finance Working Group identifies those countries most needing such U.S. training and technical assistance. To fight terrorism successfully each country must develop the necessary legal framework, banking regulation, financial intelligence unit, law enforcement, and judicial process. The United States has provided capacity-building help to countries in Africa, Asia, Europe, Latin America, and the Middle East and has cooperated with regional organizations and international financial institutions.

Celina Realuyo serves as director of Counterterrorism Finance Programs in the State Department Office of the Coordinator for Counterterrorism. Her office is responsible for coordinating U.S. counterterrorism policy and efforts with foreign governments to deter terrorist financing.

In response to the 9/11, attacks, the U.S. government launched a global war on terrorism on five fronts: military, intelligence, law enforcement, financial, and diplomatic. The United States developed a counterterrorism finance strategy based on three pillars to detect, dismantle, and deter terrorist financing networks. First, we conduct law enforcement and intelligence operations that bring terrorist financiers to justice. Second, we use public designations measures to name, shame, and block the assets of terrorist groups and their supporters. Third, we have developed capacity-building programs to reinforce the institutions of our foreign allies to proactively combat terrorist financing. While the first two pillars are retrospective, investigating known funding operations after the fact, the third pillar of capacity building focuses on enhancing countries' capabilities to safeguard international financial systems from abuse by terrorist financiers.

Coordinating Training and Technical Assistance

In the wake of the 9/11 attacks, the State Department spearheaded the creation of the Terrorist Finance Working Group (TFWG) to coordinate, develop, and provide training and technical assistance to our foreign partners deemed most vulnerable to terrorist financing. The TFWG, co-chaired by the State Department's Office of the Coordinator for Counterterrorism (S/CT) and the Bureau for International Narcotics and Law Enforcement Affairs (INL), includes various U.S. government agencies from the departments of State, Treasury, Justice, and Homeland Security and meets biweekly to receive intelligence briefings, schedule assessment trips, review country reports, and discuss the development and implementation of technical assistance and training programs. This interagency group leveraged the U.S. government's existing expertise in its efforts to combat

money laundering and organized crime and was aimed at addressing terrorist financing.

Targeting Assistance

Inundated with requests for assistance from our foreign allies, the TFWG developed the following process to prioritize the use of our limited financial and human resources to build comprehensive anti-money laundering and counterterrorist finance (AML/CTF) regimes through U.S. foreign assistance:

• Identify and prioritize countries needing the most assistance to deal with terrorist financing with input from the intelligence and law enforcement communities.

• Evaluate priority countries' CTF regimes with a Financial Systems Assessment Team (FSAT) comprising legal, financial, and law enforcement experts. The FSAT team usually spends one week in country to meet with host government authorities from the ministries of justice, interior, and finance; law-enforcement authorities; the central bank, and the private sector to see how they address money laundering and terrorist financing crimes.

• Prepare a formal assessment report on vulnerabilities to terrorist financing and make recommendations for training and technical assistance to addresses these weaknesses. The team delivers its report in about a month. The formal report is shared with the host government to gauge its receptivity to and coordinate U.S. offers of assistance.

• Develop a training implementation plan based on these recommendations. Assistance programs from U.S. government experts may include legal drafting assistance to ensure that the host nation's legal regime meets international standards, financial regulatory training, financial intelligence unit development, investigative training to "follow the money," and judicial and prosecutorial training.

• Provide training and technical assistance to priority countries on establishing the legal framework to criminalize money laundering and terrorist finance and then train law-enforcement agents and prosecutors to apply the law. This assistance can be provided in the country, in the region, or in the United States.

• Encourage burden sharing in capacity building with our allies, international financial institutions (International Monetary Fund or IMF, World Bank, regional development banks), and through international organizations such as the U.N. Committee, Financial Action Task Force (FATF) on money laundering, and G8.

Basic Tenets of an Effective Regime

After the 9/11 attacks, the United States and its allies quickly recognized the urgent need to detect, dismantle, and deter terrorist financing networks around the world. To this end, each country must develop the legal, financial regulatory, financial intelligence, law-enforcement, and prosecutorial capabilities and institutions to effectively combat terrorist financing and money laundering. The TFWG has organized and developed U.S. training programs around these five basic tenets of an effective counterterrorist finance regime.

I. Legal Framework to Criminalize Terrorist Financing. To comply with the U.N. Security Council Resolution 1373 and the FATF eight Special Recommendations on Terrorist Financing, each state is required to criminalize terrorist financing and money laundering. Legislation should establish effective measures to block and seize assets of terrorist financiers and their supporters. Each country should provide its law enforcement agents and judicial branch with ample authority to pursue and prosecute terrorist financing cases. Every country should ratify the U.N. instruments related to terrorism at the earliest opportunity. Robust counterterrorist financing and anti-money laundering legislation provides a country with the requisite legal foundation to combat money laundering and terrorist financing.

The United States may provide technical assistance on drafting legislation that criminalizes terrorism and terrorist financing to countries that request such assistance through the Department of Justice and U.S. Agency for International Development. In certain cases, the United States can arrange for resident legal advisors to provide assistance to judicial officials in their home country.

II. Financial Regulatory Supervision to Protect Integrity of the Banking System. Protecting the financial sector from terrorist financing and criminal

abuse is a key element in our CT Finance Training and Technical Assistance strategy. Under international standards, each country must determine which regulatory agency will be responsible for banks' and non-bank financial institutions' compliance with measures to combat terrorist financing. Governments should develop strict regulatory and anti-money laundering compliance measures and create a formal system for financial institutions to report suspicious activities to the regulatory agencies. Each country should establish penalties such as monetary fines to ensure the effectiveness of the compliance regime. The central bank, investment regulators, and other supervisory agencies need to educate the private sector as to possible abuse by terrorists.

The United States may provide assistance to strengthen the financial regulatory regimes of countries that request such assistance through our regulators including the Federal Reserve, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency. Training includes courses for bank examiners on reporting suspicious activity reports and detecting terrorist financing and money laundering schemes.

III. Financial Intelligence Unit as the Link Between the Private and Public Sectors. Each country should establish a financial intelligence unit (FIU) to collect, analyze, and disseminate financial intelligence and pass legislation to authorize such data collection. The FIU should develop an efficient system for financial institutions and government regulatory agencies to report suspicious activities related to terrorist financing and money laundering to the FIU. The FIU should be responsible for analyzing these suspicious activities reports and refer cases to law-enforcement agencies for investigation. The FIU should establish appropriate channels to share financial intelligence with its foreign counterparts to assist with financial crime investigations.

The United States, through the Treasury Department Financial Crimes Enforcement Network, provides training and technical assistance to foreign FIUs. Such assistance includes provision of equipment, information technology assessments, and specialized analytical software and analyst training for fledgling FIUs. The United States is an active member of the Egmont Group of FIUs and regularly sponsors aspiring members.

IV. Law Enforcement Investigations to Track Down Terrorist Financiers. Law enforcement agencies must be granted adequate legal authority to pursue financial crimes including terrorist financing cases. Such authority may include the power to conduct undercover operations and electronic surveillance to investigate financial crimes. Governments should establish specialized units and interagency task forces to pursue terrorist financing cases. Law enforcement agencies should coordinate investigations and prosecutions of terrorist financing cases with the judiciary branch.

The United States provides assistance programs in the form of financial investigative training to foreign law-enforcement agents who request such assistance. U.S. agencies — including the FBI, State Department's Diplomatic Security Anti-Terrorism Assistance Programs, Internal Revenue Service Criminal Investigations Division, and Bureau of Immigration and Customs Enforcement — conduct training courses for their foreign counterparts to develop the skills necessary to investigate financial crimes including terrorist financing.

V. Judicial/Prosecutorial Process to Bring Terrorist Financiers to Justice. Each government must determine which judicial unit will be responsible for prosecuting terrorist financing cases. Due to the complex technical nature of terrorist financing cases, a well-trained team of prosecutors familiar with financial crimes should be assembled to pursue these investigations. Judges and magistrates need to familiarize themselves with terrorist financing cases because they may not have tried such cases in the past.

The United States may provide technical assistance through the Department of Justice to foreign allies' judicial authorities using case studies to demonstrate how new counterterrorism finance legislation can be applied and cases prosecuted successfully.

International Efforts

Because globalization has facilitated the cross-border movement of people, products, and capital, the problem of terrorist financing must be addressed on a worldwide scale. The U.S. government sought early on to promote international cooperation on the counterterrorism capacity building front as a component of the global war

on terrorism. Accordingly, the Terrorist Financing Working Group recognized the financial and human resource constraints on counterterrorism finance efforts and encouraged international burden sharing to deliver training and technical assistance.

The United States has provided counterterrorism finance assistance to several countries in Africa, Asia, Europe, Latin America, and the Middle East on a bilateral and multilateral basis. We have worked closely with the U.N. Counterterrorism Committee and U.N. Office of Drug Control Policy to coordinate requests and offers of technical assistance. The United States has supported key initiatives by FATF to strengthen anti-money laundering and counterterrorist finance regimes. Through the G8 Counterterrorism Action Group, the United States is coordinating its assistance to frontline states in various counterterrorism areas. The United States has also worked with regional organizations such as the Organization of American States, Asia Pacific Economic Cooperation (APEC), and Organization for Security and Cooperation in Europe to raise awareness of possible abuses by terrorist financiers. We are also cooperating with the international financial institutions, including the IMF, World Bank, and Asian Development Bank, on counterterrorist finance projects that contribute to the economic development and integrity of international markets. For example, at the Bangkok Leaders meeting in October 2003, APEC launched a counterterrorism capacity-building initiative to secure the safe movement of people, goods, and money. The Regional Trade and Financial Security Initiative was established under the auspices of the Asian Development Bank to provide capacity building in the areas of anti-money laundering and counterterrorist financing and aviation, port, and maritime security.

Conclusion

To stem the flow of funds to terrorists, countries must address the threat of terrorist financing domestically and internationally to deny terrorist networks financing and safe haven. Through capacity building, a country can reinforce its legal, financial regulatory, financial intelligence, law enforcement, and judicial capabilities to combat terrorist financing. By leveraging its resources to assist countries with meeting the challenges posed by terrorist financing, the international community can better safeguard financial systems against abuse by terrorist financiers around the world. ■

RESPONSE TO BALI: AN INTERNATIONAL SUCCESS STORY

Celina Realuyo and Scott Stapleton

After the terrorist bombings in Bali, the international community came together to help Indonesia rapidly develop the capacity it needs to fight further terrorist activity. The United States, Japan, and Australia led a multilateral effort to provide law-enforcement training and bolster Indonesia's ability to combat terrorist financing. The response by Indonesia and the donor countries provides an example of how capacity building should work.

Celina Realuyo serves as director of Counterterrorism Finance Programs in the State Department Office of the Coordinator for Counterterrorism. Her office is responsible for coordinating U.S. counterterrorism policy Scott Stapleton, a State Department intern, is a senior at the Georgetown University School of Foreign Service.

The October 2002 Bali bombings and the response by the Indonesian government and the international community to the attacks offer a potent case study of counterterrorism financing strategy. This strategy has been transformed into action through comprehensive law enforcement, public designation, and capacity building operations. On October 12, 2002, Indonesia experienced what was then the largest terrorist attack since 9/11 the year before. The Bali bombings abruptly woke Indonesia to the reality of international terrorism. In the aftermath of the bombings, Indonesia worked tirelessly with its international partners to strengthen its defenses against the threats of terror, including its efforts to stem the flow of funds to terrorists.

Arresting Those Responsible

The Bali bombings began at 11:05 p.m. October 12, 2002, when an explosive device was electronically detonated inside a crowded bar in the heart of the island resort's entertainment district. Seconds later, as victims ran from the site of the first explosion, a minivan packed with explosives detonated nearby. Terrorists had strategically targeted young tourists at popular nightspots, leaving 202 people killed, including 88 Australians, 38 Indonesians, and seven Americans. The devastating attack on innocent civilians was compounded by dramatic economic consequences for Indonesia. The terrorist operation, which cost about $35,000, shattered Bali's tourist industry, leading to losses estimated in the millions of dollars. Indonesia, unprepared to counter the growing dangers posed by terrorist groups, eagerly met a coalition of countries willing and able to provide extensive guidance and assistance on counterterrorism.

With the aid of its international allies, Indonesia quickly launched a credible and professional law enforcement campaign to investigate and capture the terrorists

responsible for the attack. Australian and U.S. law-enforcement experts were deployed to Indonesia to assist with the various aspects of the Bali bombing investigation, from identifying the victims to following the money trail. To date, 80 Jemaah Islamiya members have been arrested in conjunction with the Bali operation. As a result of coordinated law enforcement efforts to prepare sound evidentiary packages, Indonesian judicial authorities have successfully prosecuted the Bali bombing perpetrators and delivered 33 convictions, including three death and numerous life sentences as of June 2004.

Jemaah Islamiya Public Designation

Jemaah Islamiya (JI), an al-Qaida-linked terrorist network based in Southeast Asia, was initially connected to the attack. JI is committed to the creation of an Islamic caliphate in Southeast Asia. Though little is known about the number of JI numbers, they receive substantial contributions from Middle Eastern and Southeast Asian supporters, including al-Qaida. JI recruited and trained extremists throughout the 1990s, resulting in a series of attacks that began in 2000.

In the wake of the bombings, international outrage resulted in an immediate response. On October 23, 2002, a partnership of 52 countries requested or supported the United Nations terrorist designation of Jemaah Islamiya. More than 150 jurisdictions have agreed to block the assets of JI-related targets. This designation represented the broadest and most conspicuous alliance against a terror group since the designation of al-Qaida and the Taliban after the 9/11 attacks. U.N. members were mandated to freeze and capture assets linked to JI. International public designations serve as an effective tool of the "name and shame" strategy to limit JI's maneuverability.

To underscore the importance of international cooperation to combat terrorism and revive the local economy, Indonesia and Australia co-hosted a Conference on Combating Money Laundering and Terrorist Financing December 17-18, 2002, with participants from 33 countries and 14 international organizations. The conference applauded international action through the United Nations to designate Jemaah Islamiya and called for increased international cooperation through law enforcement, intelligence, and capacity building operations in Southeast Asia and the Pacific.

Counterterrorism Capacity Building

Law Enforcement Training. Immediately following the Bali bombings, the United States, Japan, and Australia led a multilateral effort to assist Indonesia in countering terror. Faced with a very real threat, Indonesia has worked hard to build the capacity to prevent future terrorist attacks. In 2003, the State Department Office of the Coordinator for Counterterrorism planned and budgeted for the State Department Bureau of Diplomatic Security to implement an $8 million anti-terrorism assistance program to train, equip, and organize a counter-terrorism unit within the Indonesian National Police. The specialized unit is known as Special Detachment 88 (SD-88). Sixty-nine police officers have already been trained by the United States, with additional programs expected to instruct 279 officers by 2005. SD-88 has begun to integrate with Indonesia's Jemaah Islamiya Task Force, fortifying Indonesia's defenses against Southeast Asia's primary terrorist threat. Furthermore, the Department of Defense's Regional Defense Counter-terrorism Fellowship Program has spent $2.3 million training 78 Indonesian intelligence officers in English language, military professionalism, and counterterrorism-related courses.

Counterterrorism Finance Assistance. In addition to capacity building in the law enforcement arena, multilateral assistance to Indonesia has included a broad effort to help defend the financial system against abuses by terrorists. More than $820,000 has been obligated to U.S. agencies for counterterrorist financing/anti-money laundering (CTF/AML) technical assistance and training to Indonesia. In September 2002, a month before the Bali bombings, the United States took initial steps towards CTF/AML capacity building with a rough assessment of Indonesia's financial counterterrorism regime. A second team of experts was sent onsite to further evaluate Indonesia's capabilities in September 2003. Indonesia has made significant progress in reinforcing its ability to combat terrorist financing in the five key elements for an effective counterterrorist financing regime.

1. Legal Framework: Successful prosecution of terrorists relies on a strong legal framework, and the United States and its partners have assisted Indonesia in developing

AP/Wide World Photos

Aftermath of October 2002 terrorist bombing in Bali that killed 202.

strong AML/CT laws. Since July 2002, the United States has been training Indonesian and other Southeast Asian judicial authorities in drafting and amending legislation that would enable them to adopt the U.N. conventions related to terrorism and comply with U.N. Security Council Resolution 1373 to criminalize terrorist financing and money laundering. The U.S. Agency for International Development (USAID) and its Australian counterpart have been delivering legal drafting assistance to the Indonesian Central Bank and its Financial Intelligence Unit to promote economic and financial reforms. Indonesia had a weak track record in countering financial crimes and was added to the Financial Action Task Force (FATF) list of Non-Cooperating Countries and Territories in 2001. However, in September 2003, technical assistance from a U.S. interagency team helped Indonesia adequately amend its anti-money laundering legislation to meet international standards and avoid further FATF countermeasures. As a result of this legislative progress, FATF is now monitoring the implementation of the AML law.

2. Financial/Regulatory: Central banks are instrumental in monitoring and suspending money flows to terrorist groups. Indonesia has been working with the Asian Development Bank and other international donors to modernize its financial sector. In October 2003, Indonesian central bankers participated in a financial regulatory course provided by the State Department's Bureau for International Narcotics and Law Enforcement Affairs and the U.S. Office of the Comptroller of the Currency. This workshop for Southeast Asian central bankers provided technical assistance to bank regulators on how to combat terrorist financing and money laundering and how to detect suspicious activities in private banks. This training led to Bank Indonesia devising a compliance audit program for AML/CTF and plans to conduct full onsite supervision and examination of banks beginning later this year.

3. Financial Intelligence Unit (FIU): Bali's remote location and inadequate preparedness for a large-scale attack meant that national and international law enforcement agents could not rely solely on crime scene evidence to track and catch the responsible terrorists. One of the most powerful investigative tools in the Bali bombings was the analysis of communication and financial transactions between JI members. In an effort to strengthen this critical component of Indonesia's war on terror, we have worked closely with our partners from Australia's financial intelligence unit to develop the Indonesian FIU. The United States invited the Indonesian FIU to participate in a one-week training seminar entitled "Basic Analysis and Suspicious Transaction Reporting" for FIU personnel and other government officials responsible for combating money laundering and terrorist financing. Sponsored by Malaysia's Southeast Asian Regional Centre for Counterterrorism in August 2003, the conference was part of an ongoing regional effort to cooperate and coordinate with neighboring governments on counterterrorism. Through a grant from the USAID to procure essential information technology equipment, the United States directly assisted Indonesia's FIU in October 2003 to bring its electronic reporting system online to

collect suspicious transaction reports from the private sector. With this assistance from the United States and Australia, Indonesia's FIU hit a major milestone in June 2004 when it officially became a member of the Egmont Group of FIUs.

4. Law Enforcement: In January 2004, the FBI Terrorist Financing Operations Section conducted training courses on terrorist financing and money laundering investigations for 69 Indonesian National Police and other officials responsible for combating money laundering and terrorist financing. In an attempt to foster interagency cooperation in terrorist financing cases, participants included personnel from the Indonesian National Police SD-88 counterterrorism unit, financial crimes unit, and financial intelligence unit. As a result of this training, Indonesian law enforcement authorities have initiated 30 money laundering investigations, two-thirds of which have been referred to the Attorney General's Office.

5. Prosecutorial/Judicial Process: The Department of Justice's Overseas Prosecutorial Development, Assistance and Training division will assign a resident legal advisor in Jakarta to work with the host government in applying the new counterterrorism and anti-money laundering legislation. The resident legal advisor would assist with the future passage and application of new mutual legal assistance legislation.

Conclusion

In the face of continued threat of attack by Southeast Asian terror networks like Jemaah Islamiya, Indonesia has worked with the United States, Australia, and Japan, among other allies, to reinforce its counterterrorism regime. Through law enforcement operations and public designations, Indonesia responded quickly to the Bali bombings and made significant strides in rooting out the JI cell responsible for those attacks. Training and capacity building provided by the U.S. government and other international donors has had a significant impact on Indonesia's ability to prevent and respond to terrorist financing and international terrorism in general. From law enforcement programs to a comprehensive overhaul of financial and legal structures, Indonesia has benefited significantly from the continuing assistance of its allies and serves as a positive example of international capacity building efforts. ■

BANKS AND THE USA PATRIOT ACT

John J. Byrne

The American Bankers Association (ABA) supports the goal of the USA PATRIOT Act to curb terrorist financing and is particularly pleased that it extends to all financial institutions anti-money laundering requirements that previously applied only to banks. Implementing the law has revealed weaknesses, however, related to detecting those routine and often small transactions that terrorists typically have employed. The ABA advocates more sharing of intelligence about terrorists with the financial community.

John J. Byrne serves as director of the American Bankers Association's Center for Regulatory Compliance.

While the U.S. banking industry has a long history of supporting law enforcement in areas such as money laundering, Washington's efforts to curb terrorist financing through stricter banking rules are well intentioned but may miss the mark unless the government increases its commitment to provide banks with the intelligence they need.

The U.S. Congress responded to the tragic events of 9/11 by passing the 300-page law known as the USA PATRIOT Act. Acting in three weeks' time and with overwhelming bipartisan support, Congress clearly wished to enact useful and helpful legislation to address the scourge of terrorist financing. Most of the provisions, however, failed to address that particular crime.

Were these new laws necessary, or did we simply need more government intelligence? The post-9/11 briefings from law enforcement make it clear that, for the most part, the type of financial transactions that the hijackers utilized are not adequately addressed by the USA PATRIOT Act. The fact is that U.S. financial institutions, without additional government intelligence, cannot detect or prevent transactions related to terrorist financing.

This article will examine how the challenges facing the U.S. financial sector have changed since the passage of the USA PATRIOT Act in October 2001 and what else can be done to stop the flow of the financial resources to terrorists.

THE PATRIOT ACT

It is clear that the lion's share of the PATRIOT Act provisions addressing the financial industry (title III) were left over from previous unsuccessful legislative vehicles covering traditional money laundering. Despite lingering questions on how the law would be implemented and

whether it would effectively address terrorist financing, the American Bankers Association (ABA) actively supported the PATRIOT Act because it covered a myriad of new financial service providers that previously did not have anti-money laundering (AML) obligations, and it contained several other new provisions long advocated by the industry.

The key provisions of the act related to banking (and emphasized by the congressional committees responsible for authorship) include:

• making bulk cash smuggling a crime and requiring registration of black market underground financial networks

• modernizing anti-counterfeiting laws to prohibit U.S. financial institutions from providing financial services to foreign "shell" banks

• expanding public-private partnerships to help law enforcement identify, track, and stop terrorists' financial activities

• reporting "in real time" suspicious financial activity to law enforcement agencies

• requiring financial institutions to verify the identity of their new account holders, and

• requiring customers to provide financial institutions with truthful information when opening accounts

Most important to the banking industry was the provision that required all financial institutions to institute anti-money laundering compliance programs, a bank requirement since 1987.

What Changed For Banks?

As far as the practical effect of these new laws, most of the provisions simply expand obligations that were part of the AML regulatory oversight process. For example, there are provisions that require due diligence for private banking activities or correspondent bank relationships. The federal banking agencies must review and criticize banks that fail to cover those "risky" relationships with enhanced due diligence.

One of the new obligations under title III is section 326, which requires financial institutions to have account opening procedures or a "customer identification program." Banks and some covered financial institutions such as securities firms, mutual funds, and commodity futures traders (insurance companies are pending) have to obtain four pieces of information (name, address, date of birth, and government identifiers such as social security numbers) and attempt to verify that information. Because banks have been requesting identification of customers since the beginning of banking, this new obligation is a formalization of business as usual.

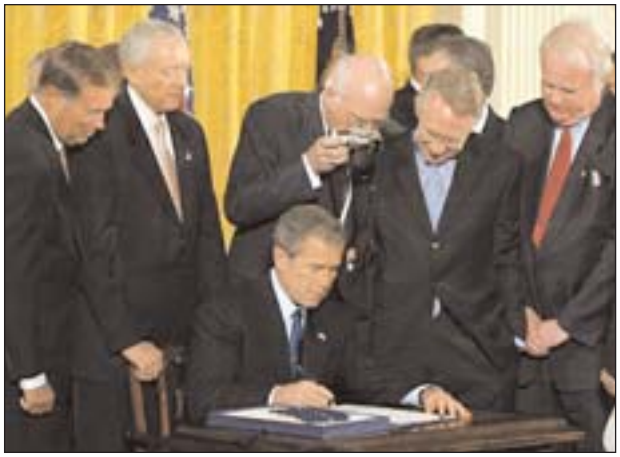
What do the changes mean for the international community?

What you may see is that a U.S. institution will want both a primary and a secondary form of identification of a potential foreign account holder. The problem with that approach is that, because many different forms of identification are unfamiliar to U.S. institutions, banks may be reluctant to open certain accounts. In addition, there are continuing issues with remote account openings since there are currently no public databases containing information to verify the identification of foreign individuals as there are for U.S. individuals. Therefore, in order to maintain relationships with U.S. financial institutions, potential foreign account holders will have to work closely with the institutions to ensure continued relationships.

PATRIOT Act Compliance

Given the increased attention to due diligence, what exactly do U.S. regulators expect banks to do to perform adequate compliance? One example is unless there is a finding by the secretary of the Treasury that certain jurisdictions cause money laundering concerns for the government, as was the case with areas such as Nauru, Ukraine, and Burma, the industry must look to other sources of information to determine whether there is a risk involved when dealing with certain jurisdictions.

One such source is the Financial Action Task Force (FATF) and its list of non-cooperative countries (NCCT). An NCCT designation means that the country had weak or non-existent laws regarding money laundering prevention. Since 2000 there have been 24 jurisdictions designated as non-cooperative. Since banks are required to carry out increased due diligence on these countries, it is important to stay abreast of these designations.



AP Photo/Doug Mills

President Bush signs the anti-terrorism bill into law during an October 2002 ceremony in the White House East Room.

It should be emphasized that financial institutions can still do business with an entity in a non-cooperative country, but they will be criticized for not spending more time reviewing the accounts in those institutions. So for a risk assessment to comply with the elements of this new law, regulators expect a bank to review publicly available information. The problem with this is that it really does not assist a bank in preventing terrorist financing.

Financial Profile of 9/11 Criminals

Our association was briefed by federal law enforcement officials on the various methods of how terrorists used the financial system prior to 9/11. One major theme should be clear: it does not cost much to rent a car, stay at a hotel, or buy a plane ticket. Therefore, terrorist financing transactions, by their very nature, are routine and are not the same as the elements of traditional money laundering.

The recently completed 9/11 Commission concluded "that the 9/11 attacks cost somewhere between $400,000 and $500,000 to execute." In addition, the 9/11 criminals' use of financial institutions was described as follows:

- Accounts were checking accounts of around $3,000.

- Applications indicated that the accountholders were "students."

- Identification used were visas issued by United Arab Emirates, Saudi Arabia, and Germany.

- Accounts were opened within 30 days of entering the country.

- Account holders checked their balances at ATMs several times a day.

According to the 9/11 Commission:

> The conspiracy made extensive use of banks in the United States, both branches of major international banks and smaller regional banks. All of the operatives opened accounts in their own names, using passports and other identification documents. There is no evidence that they ever used false social security numbers to open any bank accounts. Their transactions were unremarkable and essentially invisible amidst the billions of dollars flowing around the world every day.

In short, we believe that financial institutions could not have detected the 9/11 attackers' criminal activities without additional and specific government intelligence. Low dollar accounts cannot be effectively monitored, and creating a system to assess how often someone engages in a "transaction inquiry" at an ATM is not practical. In addition, since the identification utilized by the terrorists was not false, improved identification procedures that are required under the PATRIOT Act, while useful to prevent identity theft, would not have prevented access to a financial institution. We have learned some important lessons from the briefing mentioned above and ABA now recommends that banks not accept visas as a primary form of identification.

PATRIOT Act As Prevention Tool

One section of the USA PATRIOT Act that can address the amorphous concept of terrorist financing is Section 314(a). The 314 process requires financial institutions to search accounts for potential matches to names on government investigative lists. Under this provision:

- 314(a) requests are sent from the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) and batched and issued every two weeks, unless otherwise indicated in the request.

• After receiving a 314(a) request, financial institutions have two weeks to complete their searches and respond with any matches.

• Searches will be limited to specific records and, unless otherwise noted, will be one-time searches.

• If a financial institution identifies a match for a named subject, the institution need only respond to FinCEN that it has a match and provide point-of-contact information for the requesting law enforcement agency to follow up directly with the institution.

On the whole, these provisions are the most effective means of detecting terrorist financing because the industry is simply looking for names of individuals being investigated by the government for terrorist activity. For example, according to FinCEN, between April 1, 2003, and April 26, 2004, the Internal Revenue Service submitted 16 requests to FinCEN pertaining to 66 individuals and 17 businesses. These requests generated 646 positive matches with more than 1,274 financial institutions. Since Section 314(a)'s creation, the system has been used to send the names of 1,547 persons suspected of terrorism financing or money laundering to more than 26,000 financial institutions and has produced 10,560 matches that were passed on to law enforcement.

Other Options

As we grapple with how to prevent terrorist financing from entering the legitimate financial system, what is available beyond the section 314 process? Clearly, the new obligations under the USA PATRIOT Act do not directly address the nature of how monies enter a system to support terrorism. The various sources for banks are the FATF "typologies" on terrorist financing and similar examples provided by U.S. law enforcement agencies such as FinCEN. What do they tell us? For example, a focus on charitable organizations or "non-profit organizations" (NPOs) is a constant theme.

According to FATF:

> Most countries share the concern over the difficulties in detecting terrorist financing through misuse of NPOs. It is generally acknowledged that such organizations play a crucial social and financial support role in all societies, and obviously this role is not called into question. Nevertheless, the sheer volume of funds and other assets held by the NPO sector means that the diversion of even a very small percentage of these funds to support terrorism would constitute a grave problem. Therefore, the limited knowledge about the extent to which terrorists may be exploiting the sector should be considered a matter of serious concern for the international community.

All this emphasizes that we are in a different world now, and the tracing or monitoring of monies for terrorist activities is not a simple task.

Conclusion

Much has been written about the PATRIOT Act and the necessity of quickly enacting laws to address terrorism. Debate still rages on whether the legislative response was appropriate to the attacks. On a positive note, it should be emphasized that the ABA supported the PATRIOT Act because it accomplished what other proposals in previous times could not — requiring non-bank institutions to have AML programs and procedures. To stem the financing of terrorism, however, government must commit to providing up-to-date intelligence to the financial sector. We have seen the beginning of that process, but it must be increased. Any other strategy is doomed to fail. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

HAWALA: BASED ON TRUST, SUBJECT TO ABUSE

Mohammed El-Qorchi

Hawala is one of a number of informal systems used in many regions around the world to transfer money domestically or across borders, often in cash. Regulation of hawala is complex and demands a practical understanding of the environment in each country where hawala dealers work. Regulation should attempt not to eliminate hawala but to prevent such misuse as financing terrorism.

Mohammed El-Qorchi is deputy area chief in the International Monetary Fund's Monetary and Financial Systems Department. The text presented here has been adapted from his article in the December 2002 issue of *Finance and Development*, IMF's quarterly magazine.

Since the 9/11 terrorist attacks on the United States, public interest in informal systems of transferring money around the world, particularly the hawala system, has increased. The reason is the hawala system's alleged role in financing illegal and terrorist activities, along with its traditional role of transferring money between individuals and families, often in different countries. Against this background, governments and international bodies have tried to develop a better understanding of these systems, assess their economic and regulatory implications, and design the most appropriate approach for dealing with them.

Informal funds transfer (IFT) systems are in use in many regions for transferring funds, both domestically and internationally. The hawala system is one of the IFT systems that exist under different names in various regions of the world. It is important, however, to distinguish the hawala system from the term hawala, which means "transfer" or "wire" in Arabic banking jargon. The hawala system refers to an informal channel for transferring funds from one location to another through service providers — known as hawaladars — regardless of the nature of the transaction and the countries involved. While hawala transactions are mostly initiated by emigrant workers living in a developed country, the hawala system can also be used to send funds from a developing country, even though the purpose of the funds transfer is usually different (see box).

Why Hawala Developed

In earlier times, IFT systems were used for trade financing. They were created because of the dangers of traveling with gold and other forms of payment on routes beset with bandits. Local systems were widely used in China and other parts of East Asia and continue to be in use there. They go under various

names — Fei-Ch'ien (China), Padala (Philippines), Hundi (India), Hui Kuan (Hong Kong), and Phei Kwan (Thailand). The hawala (or hundi) system now enjoys widespread use but is historically associated with South Asia and the Middle East. At present, its primary users are members of expatriate communities who migrated to Europe, the Persian Gulf region, and North America and send remittances to their relatives on the Indian subcontinent, East Asia, Africa, Eastern Europe, and elsewhere. These emigrant workers have reinvigorated the system's role and importance. While hawala is used for the legitimate transfer of funds, its anonymity and minimal documentation have also made it vulnerable to abuse by individuals and groups transferring funds to finance illegal activities.

Economic and cultural factors explain the attractiveness of the hawala system. It is less expensive, swifter, more reliable, more convenient, and less bureaucratic than the formal financial sector. Hawaldars charge fees or sometimes use the exchange rate spread to generate income. The fees charged by hawaladars on the transfer of funds are lower than those charged by banks and other remitting companies, thanks mainly to minimal overhead expenses and the absence of regulatory costs to the hawaladars, who often operate other small businesses. To encourage foreign exchange transfers through their system, hawaladars sometimes exempt expatriates from paying fees. In contrast, they reportedly charge higher fees to those who use the system to avoid exchange, capital, or administrative controls. These higher fees often cover all the expenses of the hawaladars. The system is swifter than formal financial transfer systems partly because of the lack of bureaucracy and the simplicity of its operating mechanism; instructions are given to correspondents by phone, facsimile, or e-mail; and funds are often delivered door to door within 24 hours by a correspondent who has quick access to villages even in remote areas. The minimal documentation and accounting requirements, the simple management, and the lack of bureaucratic procedures help reduce the time needed for transfer operations.

In addition to economic factors, kinship, ethnic ties, and personal relations between hawaladars and expatriate workers make this system convenient and easy to use. The flexible hours and proximity of hawaladars are appreciated by expatriate communities. To accommodate their clients, hawaladars may instruct their counterparts to deliver funds to beneficiaries before expatriate workers make payments. Moreover, cultural considerations encourage expatriate workers to remit funds through the hawala system, and such

How Does the System Work?

A person in Country A wants to send funds to a person in country B. He initiates the transaction by giving the money to a hawaladar in country A and receives from the hawaladar an authentication code. The hawaladar in country A then instructs the hawaladar in country B to deliver an equivalent amount of funds in the local currency to the intended beneficiary. To receive the funds, the beneficiary must disclose the authentication code given to the customer in country A.

The hawaladar in country A can be compensated by charging a fee or through an exchange rate spread (the difference between the asking and buying price of a currency). After the remittance, the hawaladar in country A has a liability to his country B counterpart, which is satisfied with a payment of money or with goods and services.

The settlement of the liability also can be done through a "reverse hawala" or through imports of goods. A reverse hawala transaction is often used for investment purposes or to cover travel, medical, or education expenses from a developing country. In a country subject to foreign exchange and capital controls, a customer in country B interested in paying his son's university tuition fees, for example, provides local currency to the hawaladar in his country and requests that the equivalent amount be made available to the customer's son in country A. The hawaladar in country B may transfer funds directly to his counterpart in country A or use this transaction to settle his previous claims on the hawaladar in country A. He may also instruct an indebted hawaladar in country A to transfer funds to another hawaladar in a third country to where funds are to be delivered to settle this transaction. Furthermore, the settlement can also take place through import transactions; the hawaladar in country A would settle his debt by financing exports to country B where the hawaladar in country B would be the importer or an intermediary.

considerations also apply to family members in the home country. Many expatriate communities are exclusively male because wives and other family members remain in the home country, where family traditions prevail. These traditions may require family members, especially women, to maintain minimal contacts with the outside world. A trusted hawaladar, known in the village and aware of the social codes, would be an acceptable intermediary, protecting women from having direct dealings with banks and other agents. Thus, a system based on national, ethnic, and village solidarity depends more on absolute trust between the participants than on legal documents.

On the receiving side, repressive financial policies and inefficient banking institutions, which have often lacked interest in the remittance business, have contributed to the development of IFT systems. In addition to overly restrictive economic policies, unstable political situations have offered fertile ground for the development of the hawala and other informal systems. Most IFT systems have prospered in areas characterized by unsophisticated official systems and during times of instability. They continue to develop in regions where financial development has been slow or repressed. Overall, financial development tends to check the spread of informal fund transfer systems, even though they exist in financially mature countries as well.

Economic Implications

Despite its informality, the hawala system has direct and indirect macroeconomic implications — for financial activity as well as for fiscal performance. One aspect is its potential impact on the monetary accounts of countries on either end of the hawala transaction. Because these transactions are not reflected in official statistics, the remittance of funds from one country to another is not recorded as an increase in the recipient country's foreign assets or in the remitting country's liabilities, unlike funds transferred through the formal sector. As a consequence, value changes hands, but the broad measure of money is unaltered. However, hawala transactions may affect the composition of broad money in a recipient country. In the remittance business, such transactions are conducted mainly in cash, even though hawaladars may use the banking system for other purposes. Individuals from developing countries who transfer funds abroad through the hawala system for investment or other purposes are usually members of wealthy groups. They supply local hawaladars with cash by making withdrawals from their bank accounts. As a consequence, hawala-type transactions tend to increase the amount of cash in circulation. Furthermore, IFT systems have fiscal implications for both remitting and receiving countries because no direct or indirect tax is paid on hawala transactions. The negative impact on government revenue applies equally to both legitimate and illegitimate activities that involve the hawala system.

Hawala transactions cannot be reliably quantified because records are virtually inaccessible, especially for statistical or balance of payments purposes. This holds true for both the remitting and, especially, the receiving sides of the transactions. Hawala transactions from developing countries are sometimes driven by capital flight motivations; they may also be driven by a desire to circumvent exchange control regulations and the like, leaving no traceable records. Nevertheless, the authorities of some countries have sporadically made estimates of hawala activity based on their expatriate populations and balance of payments data. In any case, all crude estimates should take into account both hawala and reverse hawala transactions (see box) as well as transactions driven by illicit activities. Although it would be impossible to provide a precise figure, the amounts involved in hawala transactions are likely to entail billions of dollars.

Difficulties for Regulators

There is also a consensus that, in the wake of heightened international efforts to combat money laundering and terrorist financing, more should be done to keep an eye on IFT systems to avoid their misuse by illicit groups. Policymakers believe that the potential anonymity afforded by these systems presents risks of money laundering and terrorist financing that need to be addressed. Yet selecting the appropriate regulatory and supervisory response requires a realistic and practical assessment and an understanding of the specific country environment in which the IFT dealers operate.

Regulation of IFT systems in various jurisdictions will be a complex endeavor. The variety of legal systems and economic circumstances across countries make a uniform approach technically and legally impractical. In a number of countries, the hawala system is prohibited. Any attempt to regulate this system in these countries would, therefore, be at odds with existing laws and regulations and would be seen as legitimizing parallel foreign exchange operations and capital flight.

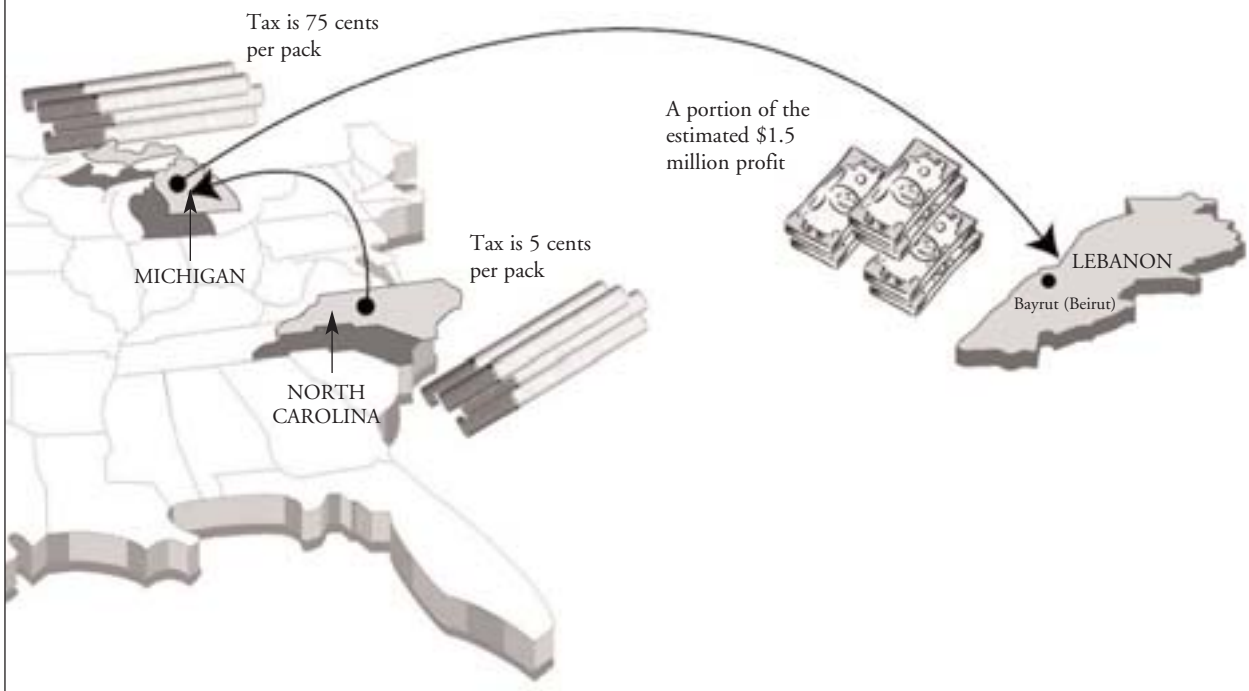
Where IFT regulations are conceivable, there is agreement that overregulation and coercive measures will not be effective because they might push IFT businesses, including legitimate ones, further underground. The purpose of any approach is not to eliminate these systems but to avoid their misuse. Against this background, policymakers tend to favor two options, which are already in force in some countries: registration or licensing of IFT systems.

While these measures could deter illegal activities, they will not, in isolation, succeed in reducing the attractiveness of the hawala system. As a matter of fact, as long as there are reasons for people to prefer such systems, they will continue to exist and even expand. If the formal banking sector intends to compete with the informal remittance business, it should focus on improving the quality of its service and reducing the fees charged. Therefore, a longer-term and sustained effort should be aimed at modernizing and liberalizing the formal financial sector, with a view to addressing its inefficiencies and weaknesses. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

HIZBALLAH SMOKESCREEN

Money from bootlegged cigarettes went into the pockets of terrorists



Between 1996 and 2000, a group of individuals affiliated with Hizballah used bulk cash to purchase about $8 million in cigarettes in North Carolina, where the cigarette tax is 5 cents per pack.

They then traveled to sell the cigarettes in Michigan, where the cigarette tax is 75 cents per pack. The group was able to avoid paying the tax to the state of Michigan, pocketing the difference in prices between the two states.

Estimated Profit: $1.5 million. A portion was sent to Hizballah in Lebanon as cash and goods.

Source: Reprinted from Government Accountability Office report "Terrorist Financing" (http://www.gao.gov/new.items/d04163.pdf).

ROLES AND RESPONSIBILITIES

Key U.S. government players in the fight against terrorist finance

Department	Bureau/division/office	Role
Central Intelligence Agency		Leads gathering, analyzing, and disseminating intelligence on foreign terrorist organizations and their financing mechanisms; charged with promoting coordination and information-sharing between all intelligence community agencies.
Homeland Security	Bureau of Customs and Border Protection	Detects movement of bulk cash across U.S. borders and maintains data about movement of commodities into and out of the United States.
	Bureau of Immigration and Customs Enforcement (ICE - formerly part of the Treasury's U.S. Customs Service)	Participates in investigations of terrorist financing cases involving U.S. border activities and the movement of trade, currency, or commodities.
	U.S. Secret Service	Participates in investigations of terrorist financing cases, including those involving counterfeiting.
Justice	Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF)	Participates in investigations of terrorist financing cases involving alcohol, tobacco, firearms, and explosives.
	Civil Division	Defends challenges to terrorist designations.
	Criminal Division	Develops, coordinates, and prosecutes terrorist financing cases; participates in financial analysis and develops relevant financial tools; promotes international efforts and delivers training to other nations.
	Drug Enforcement Administration (DEA)	Participates in investigations of terrorist financing cases involving narcotics and other illicit drugs.
	Federal Bureau of Investigation (FBI)	Leads all terrorist financing investigations and operations; primary responsibility for collecting foreign intelligence and counterintelligence information within the United States.
National Security Council		Manages the overall interagency framework for combating terrorism.
State	Bureau of Economic and Business Affairs	Chairs coalition subgroup of a National Security Council Policy Coordinating Committee, which leads U.S government efforts to develop strategies and activities to obtain international cooperation.

Department	Bureau/division/office	Role
	Bureau of International Narcotics and Law Enforcement Affairs	Implements U.S. technical assistance and training to foreign governments on terrorist financing.
	Office of the Coordinator for Counterterrorism	Coordinates U.S. counterterrorism policy and efforts with foreign governments to deter terrorist financing.
Treasury	Executive Office for Terrorist Financing and Financial Crime	Develops U.S. strategies and policies to deter terrorist financing, domestically and internationally; develops and implements the National Money Laundering Strategy as well as other policies and programs to prevent financial crimes.
	Financial Crimes Enforcement Network (FinCEN)	Supports law enforcement investigations to prevent and detect money laundering, terrorist financing, and other financial crime through use of analytical tools and information-sharing mechanisms; administers the Bank Secrecy Act.
	Internal Revenue Service (IRS) Criminal Investigation	Participates in investigations of terrorist financing cases with an emphasis on charitable organizations.
	IRS Tax Exempt and Government Entities	Administers the eligibility requirements and other IRS tax law that apply to charitable and other organizations that claim exemption from federal income tax.
	Office of Foreign Assets Control	Develops and implements U.S. strategies and policies to deter terrorist financing; imposes controls on transactions; and freezes foreign assets under U.S. jurisdiction.
	Office of the General Counsel	Chairs Policy Coordination Committee for Terrorist Financing, which coordinates U.S. government efforts to identify and deter terrorist financing; coordinates U.S. government actions regarding implementation of, and imposition of, economic sanctions under Executive Order 13224 with respect to the freezing of terrorist-related assets.
	Office of International Affairs	Provides advice, training, and technical assistance to nations on issues including terrorist financing deterrence.

Source: Reprinted from Government Accountability Office report "Terrorist Financing" (http://www.gao.gov/new.items/d04163.pdf).

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INTERNET RESOURCES

Online sources for information about terrorist financing

UNITED STATES GOVERNMENT

U.S. Department of Homeland Security
Immigration and Customs Enforcement (ICE)
Operation Cornerstone
http://www.ice.gov/graphics/cornerstone/index.htm

U.S. Department of Justice
Criminal Division
Asset Forfeiture and Money Laundering Section (AFMLS)
http://www.usdoj.gov/criminal/afmls.html

U.S. Department of State
Bureau of Economic and Business Affairs
Energy, Sanctions and Commodities
Office of Terrorism Finance and Economic Sanctions Policy
http://www.state.gov/e/eb/c9997.htm
Counterterrorism Office
Counterterrorism Finance and Designation Unit
http://www.state.gov/s/ct/terfin

U.S. Department of the Treasury
Office of Terrorism and Financial Intelligence
http://www.treas.gov/offices/eotffc/index.html
Office of Foreign Assets Control (OFAC)
http://www.treas.gov/offices/eotffc/ofac/index.html
Executive Office for Asset Forfeiture
http://www.treas.gov/offices/eotffc/teoaf/
Financial Crimes Enforcement Network (FINCEN)
http://www.fincen.gov
USA Patriot Act Information
http://www.fincen.gov/pa_main.html

INTERNATIONAL ORGANIZATIONS

Asia Pacific Group on Money Laundering
http://www.apgml.org/

Caribbean Financial Action Task Force
http://www.cfatf.org/

Financial Action Task Force on Money Laundering (FATF)
http://www.fatf-gafi.org/

Financial Services Authority
Terrorist Financing and Sanctions Information
http://www.fsa.gov.uk/pubs/other/us_events/

Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)
http://www.fintrac.gc.ca/

LAWS AND REGULATIONS

Executive Order 13315 on Blocking Property of the Former Iraqi Regime, August 28, 2003.
http://www.treas.gov/offices/eotffc/ofac/legal/eo/13315.pdf

Executive Order 13224 on Terrorist Financing
With updates to annex of persons and of organizations that commit, threaten to commit, or support terrorism, September 24, 2001.
http://www.ustreas.gov/offices/enforcement/ofac/sanctions/t11ter.pdf

Financial Crimes Enforcement Network
Amendment to the Bank Secrecy Act Regulations
http://www.treas.gov/press/releases/docs/sar.pdf

Specially Designated Nationals (SDNs) and Blocked Persons
August 10, 2004
http://www.ustreas.gov/offices/enforcement/ofac/sdn/t11sdn.pdf
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http://www.state.gov/s/ct/rls/fs/2002/15222.htm

USA PATRIOT Act, October 26, 2001.
http://www.fincen.gov/hr3162.pdf

Financial Action Task Force on Money Laundering
Special Recommendations on Terrorist Financing
October 2001
http://www1.oecd.org/fatf/SRecsTF_en.htm

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http://usinfo.state.gov/journals/journals.htm

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ECONOMIC PERSPECTIVES

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