

# **Follow the Money: Tracing Terrorist Assets**

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*15 April 2002*

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## CHAPTER 1: INTRODUCTION

The attacks of September 11<sup>th</sup>, 2001, opened a new era in American interaction with the world abroad, and raised novel challenges for the US government. There are naturally many facets of the war on terror: military, political, and economic. This paper focuses on the financial, and specifically regulatory, responses that have been made necessary. Adequate financial resources have been shown to be as vital to terrorist operations as training camps, highly motivated individuals, and ruthless leadership. Any means that weakens the financial structure supporting terrorist activities, whether in the United States or abroad, must inevitably represent an advance for American policy.

The prospective role for financial counter-measures, however, should not be overstated. It is the thesis of this paper that while particular regulatory measures may be incrementally useful, no feasible regulatory system could ever completely squeeze dry the flow of funds to terrorist organizations. The United States and its allies can, however, use financial investigation as a powerful weapon in the anti-terrorist arsenal.

Terrorism is a crime. It is defined under Title 18 of the United States Code relating to Federal crimes, and carries penalties ranging from imprisonment to the death penalty.<sup>1</sup> This paper, however, does not intend to examine the underlying crime of terrorism, but rather the government's response to terrorist activities through investigation of the asset flows which make terrorism possible.

Indeed, one of the central concepts of the following discussion is that careful cost/benefit analysis is crucial for determining which measures are likely to be most helpful to law enforcement

authorities, intelligence agencies, and military commanders, while creating the least disturbance in the financial system and imposing the lightest burden on regulatory systems. One of the great strengths of the United States' economy is its efficient, highly liquid and largely self-monitoring financial network, and zealous pursuit of terrorists, if it impedes the functioning of that system, would simply do the terrorists' work for them.

Further, this paper focuses on asset tracing rather than asset seizure. There is some overlap between the laws, regulations, and administrative agencies involved in asset seizure and asset tracing, but the goal of the two procedures is different. Asset seizure is intended to deprive a terrorist of necessary operational material, the means by which to carry out an attack. Asset tracing is focused on attacking terrorism indirectly, by providing law enforcement authorities, intelligence analysts, and military commanders information on who the terrorist organizations are and where they are located. While both approaches are valuable, it will be argued that a focus on asset tracing will contribute more to the eventual success of anti-terrorist efforts.

This paper discusses the legislative, regulatory, institutional, and international aspects of asset tracing. The next chapter describes the international financial system – classes of financial institutions and types of transactions – as they are understood in the context of anti-terrorism investigation efforts, and discusses the particular transactions which pose the greatest threat of misuse by terrorist organizations. The third chapter analyzes the existing domestic legal structures currently in place to support US governmental authorities, and the organization of the governmental agencies which enforce those laws and regulations. The fourth chapter examines the system of cross-border cooperation, whether bi-, pluri-, multi- or inter-national, and the role

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<sup>1</sup> 18 USC §§2332 et seq.

of the United States in the international sphere. The final chapter lays out several specific proposals, applicable on the domestic and international front.

## CHAPTER 2: THE STRUCTURE OF TERRORIST FINANCING

Terrorist rely on the international financial system to carry out their operations. Individuals must be trained, weapons must be purchased, bribes must be paid, travel and infiltration must be financed. Most of these operations are moderately expensive – beyond the financial means of individual terrorists – and therefore require the collection and distribution of funds by a terrorist organization. In addition, many operations, such as the attacks on September 11<sup>th</sup>, require the international movement of individuals and their financial support while abroad.

Effective monitoring of the financial system, in theory, may further the war on terror either of two ways: (i) by preventing future acts of terror directly – robbing the terrorists of the financial means to carry out their attacks; and (ii) by providing information to law enforcement authorities, intelligence agencies, and military personnel, assisting them to identify and locate the individuals, organizations, and states which are responsible for supporting and carrying out acts of terror. This section will argue that the latter course, in the medium- and long-term, is likely to be more profitable.

### **The international financial system**

The international financial system must be understood to include a wide variety of financial institutions and other forms of commercial enterprises. Not all of these are even legally recognized, and even those formally termed financial institutions are frequently not subject to effective regulation.

The ‘standard’ units in the international financial system are the licensed financial institutions based in highly industrialized countries – banks, insurance companies, savings and loans, foreign exchange offices, securities brokerages, credit card companies, etc. In general, these firms are created under well-established corporate laws and required to comply with detailed regulations enforced by governmental inspection and backed up by the threat of civil or criminal penalties. Even within this category of formal financial organizations, however, it should be recognized that regulatory oversight provisions are highly unequal. Banks in the United States, for example, must adhere to far more rigorous regulations in many fields relating to terrorist financing (“know your customer” rules, for example, and the mandatory filing of suspicious activity reports) than some other types of institutions.

Existing at a slightly lower level of formality are financial institutions based in ‘low regulation’ jurisdictions, either in purposefully slack offshore havens such as the Cayman Islands or in less developed countries where regulators lack the resources, training, and perhaps political motivation to effectively monitor their financial sector. Such jurisdictions have traditionally posed a serious challenge to rich-country regulators: some financial transactions with such institutions may be unquestionably legitimate, yet their interaction with on-shore institutions opens a massive gap in regulatory capabilities. The United States can hardly prohibit Citibank from accepting funds from a bank based in Bulgaria or the Isle of Man; simultaneously, however, US regulators can have very little certainty regarding the ultimate ownership of assets held in correspondent accounts established by those institutions. Anti-money laundering efforts have focused, with only moderate success, on persuading or pressuring such low-regulation jurisdictions to improve their scrutiny of such institutions. The incentive structure for at least a number of countries will be always on the side of permissiveness, however: some states will always be tempted by the relatively rich rewards offered by individuals seeking to avoid

governmental oversight, and to date the sanctions imposed by rich-countries have not been sufficient to deter to make those rewards unappetizing.

Most problematic in the ‘low regulation’ category are “shell banks.” These banks are established at low cost in lightly regulated jurisdictions and typically have opaque ownership structures, with the shareholders designated either as a private corporation or organized through a trustee. A shell bank transacts business in high-regulation “on shore” jurisdictions through correspondent accounts maintained with recognized foreign banks. The correspondent bank – in Europe or Asia, for example – knows only that the account holder, its customer, is another bank, and has no means of discovering the ultimate beneficiary of the funds it holds.<sup>2</sup>

Finally, at the lowest end of the international financial structure, are what the OECD’s Financial Action Task Force (FATF) rather euphemistically refers to as “alternative remittance systems.”<sup>3</sup> These are essentially means of moving money across international borders without that money coming into contact with formal financial institutions, even lightly regulated ones. Alternative remittance systems developed partially as a response to governmental restrictions on flows of legitimate funds (export licensing, artificially controlled exchange rates, and the like), partially as a low-cost provider of international financial services for individuals who did not have accounts with official banks, and partially as a result of official institutions’ failure to guarantee reliable and timely movement of funds. These systems have generally survived to the present day, however, because of the benefits they offer for illicit finance.<sup>4</sup>

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<sup>2</sup> In fact, while still the situation in many other jurisdictions, correspondent accounts for shell banks were effectively banned by Congress in the aftermath of September 11<sup>th</sup>. See 31 USC §5318(j).

<sup>3</sup> See Extract from the FATF-XI Report on Money Laundering Typologies 1999-2000, [www.fatf-gafi.org/FATDocs\\_en.htm#Trends](http://www.fatf-gafi.org/FATDocs_en.htm#Trends) (3 February 2000).



There are three major global alternative remittance systems. The Black Market Peso Exchange developed in Latin America, and is currently utilized both by narcotics traffickers and by immigrant workers to move the proceeds of their activities (either wages or drug money) back to their home countries from the United States. The Chinese or East Asian system may actually predate the official banking system in parts of Asia and is used both for both business income and profits from the drug trade.<sup>5</sup>

The third system, Hawala or Hundi, has attracted the most attention recently because of its intensive association with Arab countries, eastern and southern Africa, and southern Asia.<sup>6</sup> While the system is illegal in a number of countries, it can also be quite pervasive – it is estimated that 50% of the Indian economy depends on Hawala transfers, despite legal prohibitions.<sup>7</sup> Hawala systems have also been linked to narcotics, trafficking in human beings, terrorism, corruption, and smuggling.<sup>8</sup> Transfers effected through the Hawala system cost less than transfers through official banks, operate efficiently and reliably, and require almost no documentation.

Hawala operates through independent brokers, “hawaladars,” who maintain running balances with other such brokers in other towns or countries. An individual may deposit Sterling funds with a hawaladar in the UK, for example, and request that an equivalent amount, either in rupees or gold, be paid out to a beneficiary in India. Accounts between hawaladars are periodically netted out and settled through reciprocal remittances, trade invoice manipulation, commodity smuggling, bank transfers, or unreported movement of currency.<sup>9</sup>

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<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

<sup>6</sup> FATF-XI Report.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

Alternative remittance systems are already illegal in many systems or suffer severe legal disabilities. They are nevertheless difficult to penetrate by law enforcement authorities, and their continued existence open a massive breach through which terrorist funds can penetrate the border defenses of otherwise highly regulated financial systems.

Finally, the role of ancillary agents in the financial system should not be overlooked. Lawyers and accountants both play critical roles in structuring offshore accounts and shell corporations, and in organizing the procedures by which money is moved surreptitiously outside the reach of government regulators. Though this activity is more commonly associated with tax avoidance schemes than with conscious connivance with terrorists, the existence of well-established and carefully crafted ‘regulatory escape plans’ undoubtedly provides useful blue-prints to those wishing to move money around the world for more dangerous purposes.

Non-financial sector services may also be seen as involved in international transfers of funds. Casinos and bookmakers generate large sums of cash which may be used to disguise illicit funds transferred abroad. Real estate investments have been used as a means of transferring ownership of assets across borders. Shipment and sale of gold, and simple smuggling of large quantities of currency, are both frequently used to evade the formal system of inter-bank transfers.<sup>10</sup>

### **The money laundering model**

The traditional law enforcement response to illicit movements of currency has been in the form of anti-money laundering programs. These initiatives, legislative and institutional, derive almost

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<sup>9</sup> Ibid.

<sup>10</sup> See Commonwealth Secretariat, Combating Money Laundering: A model of best practice for the financial sector, (Commonwealth Secretariat: London, 2000) 113.

entirely from campaigns against on tax evasion and drug smuggling, and where shaped by that focus.

The archetypal money laundering operation involves money derived from an illegal source: proceeds of drug sales, bribes received by corrupt officials, funds whisked away from the IRS through tax evasion. The criminal attempts first to eliminate conspicuous qualities of his dirty money, such as large of quantities of cash (the 'placement' phase). He then disguises the origins of the funds through complex, contingent, and repetitive international transactions, often involving a number of different types of assets (cash, securities, real estate, gold, etc.). This process disrupts the audit trail and provides anonymity (the 'layering' phase). Finally, he returns the funds to the legitimate economy, either for his own use or to finance new criminal enterprises (the 'integration' phase).<sup>11</sup>

Because of the complexity of the layering process, the most effective anti-money laundering techniques have focused disproportionately on identifying laundered funds at the placement stage. Most highly regulated financial systems, including the United States, require that banks report to the authorities transactions involving large quantities of cash or other transactions which seem abnormal or suspicious. The Egmont Group of Financial Intelligence Units, for example, released a study compiling case studies of successful anti-money laundering actions from a number of different jurisdictions.<sup>12</sup> The indicators of illicit activity which had alerted banks to malfeasance included:

- large-scale cash transactions,
- a new customer attempting large transactions with no supporting rationale,
- unusual underlying business transactions,

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<sup>11</sup> See Commonwealth Secretariat, Combating Money Laundering: A model of best practice for the financial sector, (Commonwealth Secretariat: London, 2000) 6-7.

<sup>12</sup> Egmont Group, FIU's in Action: 100 Cases from the Egmont Group (London: Egmont Group, 2000).

- unrealistic business turnover,
- rapid offshore transfer of deposited funds,
- unrealistic wealth compared to client's profile,
- unrealistic explanations given by customer to explain account activity,
- re-activation of dormant accounts,
- unusually complex methods of purchasing financial products,
- deposits made at a variety of bank branches for no logical reason
- lack of knowledge by client atypical of true trade practitioner,
- attempts to avoid identifying ultimate account beneficiaries,
- complex fund structures, and
- use of false documentation.

### **The terrorist financing model**

The model for terrorist financing, by contrast, seems to have a rather different character from traditional money laundering activity. As an example, the FBI has described the financing of the September 11<sup>th</sup> attacks as follows:

The 19 hijackers opened 24 domestic bank accounts at four different banks. The following financial profile was developed from the hijackers' domestic accounts:

#### **Account profile**

- Accounts were opened with cash/cash equivalents in the average amount of \$3,000 to \$5,000.
- Identification used to open the accounts were visas issued through Saudi Arabia or the U.A.E.
- Accounts were opened within 30 days after entry into the U.S.
- All accounts were normal checking accounts with debit cards.
- None of the hijackers had a social security number.
- They tended to open their accounts in groups of three or four individuals.
- Some of the accounts were joint accounts with others.
- Addresses used usually were not permanent (i.e. mail boxes, etc.) and changed frequently.
- Hijackers would often use the same address/telephone numbers on the accounts.
- No savings accounts or safe deposit boxes were opened.
- Hijackers would open their accounts at branches of large well known banks.
- The majority of hijackers (12) opened accounts at the same bank.

#### **Transaction profile**

- Some accounts would directly receive/send wire transfers of small amounts to foreign countries UAE, Saudi Arabia, Germany.
- Hijackers would make numerous attempts of cash withdrawals which often would exceed the limit of the debit card.
- High percentage of withdrawals were from debit cards vs. low percentage of checks written.
- Numerous balance inquiries were made.
- Hijackers would often travel domestically.
- There was a tendency to use Western Union to wire money.

- One deposit would be made and then the money would trickle out a little at a time.
- Account transactions did not reflect normal living expenses for rent, utilities, auto payments, insurance, etc.
- There was no normal consistency with timing of deposits/disbursements.
- Funding for normal day to day expenditures was not evident from transactions.
- Overall transactions are below reporting requirements.
- Funding of the accounts dominated by cash and overseas wire transfers.
- ATM transactions occur where more than one hijacker present (uninterrupted series of transactions involving several hijackers at the same ATM).
- Use of debit cards by hijackers who did not own affected accounts.

#### International Activity

- Three of the hijackers supplemented their financing by opening foreign checking accounts and credit card accounts at banks located in the UAE.
- While in the U.S., two of the hijackers had deposits made on their behalf by unknown individuals.
- Hijackers on all four flights purchased traveler's checks overseas and brought them to the U.S. These traveler's checks were partially deposited into their U.S. checking accounts.
- Three of the hijackers (pilots/leaders) continued to maintain bank accounts in Germany after moving to the U.S.
- Two of the hijackers (pilots/leaders) had credit cards issued by German banks and maintained those after moving to the U.S.
- It is suspected that other unknown foreign accounts exist that were opened by the hijackers to further supplement the financing of the September 11, 2001, attacks.
- One of the hijackers (pilot/leader) received substantial funding through wire transfers into his German bank in 1998 and 1999 from one individual.
- In 1999, this same hijacker opened an account in the UAE, giving power of attorney over the account to this same individual who had been wiring money to his German account.
- More than \$100, 000 was wired from the UAE account of the hijacker to the German account of the hijacker in a 15-month period.<sup>13</sup>

In summation, the head of the FBI's financial investigative unit stated "Terrorist financing methods range from the highly sophisticated to the most basic. There is virtually no financing method that has not at some level been utilized by terrorists and terrorist groups."<sup>14</sup>

Several differences from traditional money laundering are evident. First, the fundamental feature of money laundering is that the money is tainted at the outset, and subsequent transfers are

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<sup>13</sup> Dennis M. Lormel, Chief, Financial Crimes Section, Federal Bureau of Investigation, Statement for the Record, House Committee on Financial Services, Subcommittee on Oversight and Investigations, Washington, D.C., February 12, 2002.

designed to remove or disguise that illicit origin. By contrast, while some terrorist money may derive from illegal activities, there is no reason to assume that all of it does. Indeed, recent reports indicate that some money involved in terrorist activities derives from charitable organizations.<sup>15</sup> Osama bin Laden himself seems to have operated a number of legitimate or quasi-legitimate businesses, the proceeds from which would not have been subject to seizure as laundered funds.<sup>16</sup>

Second, the amounts involved need not be nearly as large as those involved in drug trafficking or tax evasion. While bin Laden himself has been rumored to have a personal fortune of up to \$300 million, only \$70 million in terrorist assets have been seized worldwide as directly belonging to terrorists or terrorist organizations, as of March 17, 2002, and a far smaller amount was needed to put into operation the September 11<sup>th</sup> attacks.<sup>17</sup> These sums hardly compare with the \$600 billion to \$2 trillion estimated to be globally laundered each year as the proceeds of international crime.<sup>18</sup> This fact is important simply because large quantities of money are easier to detect and track than small sums.

Third, it appears that unlike the proceeds from drug trafficking or tax evasion, terrorist assets will frequently enter the financial system abroad. This proposition seems to be grounded in the reality that international terrorist do not receive the bulk of their financing from the citizens and rulers of their target nations. Given this fact, terrorist organizations will intentionally seek out lightly

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<sup>14</sup> Ibid.

<sup>15</sup> Ibid. Mr. Lormel comments that “One of the challenges in investigations involving terrorist fund-raising through NGOs is distinguishing terrorist fund-raising activities from legitimate or what may appear to be legitimate charitable fund-raising. The line is often blurred.”

<sup>16</sup> Kevin J. Cloherty and Jill Brenner, “Targeting Terror Dollars: Some Lessons from the Drug War,” Andrew’s Bank & Lender Liability Litigation Reporter, Vol. 7, No. 11 (December 20, 2001).

<sup>17</sup> See The New York Times, “Finances of Terror,” September 24, 2001; see also John J. Lumpkin, “Second Wind for Al-Qaeda?” The Record (Bergen County, NJ), March 17, 2002.

regulated jurisdictions in which to first deposit their money.<sup>19</sup> Traditional strategies of catching illicit funds at the placement stage are therefore much less likely to be applicable to the war on terror. At least in the medium term, the United States cannot assume that all foreign jurisdictions will provide adequate supervision of deposits to prevent the entry of terrorist finance into the official banking system.

In essence, the search for terrorist finances runs the standard money laundering scheme in reverse: rather than a funnel, beginning as a myriad of tiny payments originating in a rich country and sliding down toward a few individuals in a poor country (the drug money model), anti-terrorist authorities find a spider-web of fewer sources, located in under-regulated areas, connected to a larger number of recipients.

With drug financing, tracing the flow of funds backward from recipient toward the depositor does law enforcement little good – going backward, one merely ends up with a lowly henchmen on a street corner. With terrorist assets, however, working backward from recipients (the man with a gun on a plane) is exactly what is required: if any of the (larger group) of recipients are identified, then tracing transactions back up the chain of transactions results in locating the assets of the originator. The tactics necessary for tracing transaction back to their source are thus the appropriate ones for the current regulatory initiatives.

Asset tracing is therefore a more profitable endeavor for law enforcement agencies involved in the anti-terror campaign. The amount of money involved in terrorist activities is so small that it

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<sup>18</sup> For the estimate of \$600 million, see Pub.L. 107-56, Title III, § 302, Oct. 26, 2001, 115 Stat. 296, “Findings and Purpose;” for the estimate of \$2 trillion, see Department of the Treasury, FinCEN, [www.ustreas.gov/fincen/int\\_main.html](http://www.ustreas.gov/fincen/int_main.html).

<sup>19</sup> Although in the case of the September 11<sup>th</sup> hijackers, at least some of the financing seems to have passed through Germany, a well-regulated jurisdiction, before reaching the United States

will almost certainly slip through any net of realistic, practical regulations. The amount of money available for terrorist enterprises is clearly larger than the amount which can be effectively frozen or confiscated. This fact holds true for individuals, organizations, and state sponsors of terrorism.

Yet simply tracing the financial transactions themselves provides anti-terrorism intelligence of the same magnitude: simply knowing who the donor is and where he is located may be enough for military action to eliminate him; discovering the mechanisms he uses to finance his network allows law enforcement authorities to disrupt his attacks. Seizing the money is not as important, nor as feasible, as seizing the information which the money flow contains. The balance of this paper will therefore concentrate on the mechanisms, domestically and internationally, which allow American investigators to trace terrorist finances back to their origins.



### CHAPTER 3: THE DOMESTIC REGULATORY ENVIRONMENT

The US government's authority to attack assets of terrorists derives from an elaborate conglomeration of legislation. The regulations which implement those laws, and the investigations which give them teeth, are put into place by a diverse group of Federal law enforcement and financial regulatory agencies. This section attempts to map out the domestic legal and institutional framework currently in place for the tracing of terrorist assets.

#### **The crime of money laundering**

Money laundering statutes are intended to attack the financial transactions associated with an underlying crime, such as terrorism, drug smuggling, or fraud. Anti-money laundering provisions are generally supported by law enforcement agencies because they allow a broader net to be cast over a criminal organization, catching not only those directly involved in the underlying activity but also those who provide indirect support – in the case of terrorism, donating the funds and supplying the materials that make the crime possible.

The US anti-money laundering statutes were devised in the 1970s as a response to criminals' use of the financial system to hide the proceeds of drug sales and tax evasion, and the statutes have evolved gradually over the last three decades to encompass a wider range of underlying crimes, including foreign corruption and terrorism. The heart of the US anti-terrorist financial legislation is embodied in 18 USC § 1956, and criminalizes transfers of funds across the US border which are intended to promote criminal activity.

§1956(a) states:

(2) Whoever transports, transmits, or transfers, or attempts to transport, transmit, or transfer a monetary instrument or funds from a place in the United States to or through a place outside the United States or to a place in the United States from or through a place outside the United States--

(A) with the intent to promote the carrying on of specified unlawful activity...

shall be sentenced to a fine of not more than \$500,000 or twice the value of the monetary instrument or funds involved in the transportation, transmission, or transfer whichever is greater, or imprisonment for not more than twenty years, or both....

(3) Whoever, with the intent--

(A) to promote the carrying on of specified unlawful activity...[or]

(C) to avoid a transaction reporting requirement under State or Federal law,

conducts or attempts to conduct a financial transaction involving property represented to be the proceeds of specified unlawful activity, or property used to conduct or facilitate specified unlawful activity, shall be fined under this title or imprisoned for not more than 20 years, or both. For purposes of this paragraph and paragraph (2), the term "represented" means any representation made by a law enforcement officer or by another person at the direction of, or with the approval of, a Federal official authorized to investigate or prosecute violations of this section.<sup>20</sup>

Thus the crime of money laundering includes both the transfer of funds intended to be used for terrorism and those funds which a Federal official "represents" as being intended for that purpose – a provision granting significant discretion to the Treasury. "Specified Unlawful Activity" is defined very broadly in §1956(c)(7) to include acts of terrorism, both those committed in the United States, §1956(c)(7)(D), and those committed abroad which involved financial transactions partially occurring in the United States, §1956(c)(7)(B).<sup>21</sup>

Other terms in this section, are likewise given broad scope and should pose no obstacles to enforcement:

(c)(3) the term "transaction" includes a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes a

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<sup>20</sup> 18 USC §1956(a)(2) and (3). Paragraphs related to proceeds of criminal activities have been omitted.

<sup>21</sup> 18 USC §1956(c)(7).

deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, use of a safe deposit box, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected;

(4) the term "financial transaction" means (A) a transaction which in any way or degree affects interstate or foreign commerce (i) involving the movement of funds by wire or other means or (ii) involving one or more monetary instruments, or (iii) involving the transfer of title to any real property, vehicle, vessel, or aircraft, or (B) a transaction involving the use of a financial institution which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree;

(5) the term "monetary instruments" means (i) coin or currency of the United States or of any other country, travelers' checks, personal checks, bank checks, and money orders, or (ii) investment securities or negotiable instruments, in bearer form or otherwise in such form that title thereto passes upon delivery...<sup>22</sup>

The extraterritorial effect of these provisions, however, are significantly limited. The two strongest assertions of extraterritorial power derive from §1956(b)(2)(A) and (C), which state that the US will have jurisdiction over (i) all foreign individuals who violate the statute in such a way that part of the financial transaction involved occurs in the United States, and (ii) over all foreign financial institutions that maintain a bank account in the United States. Under §1956(b)(3), courts are authorized to impose pre-trial blocking orders on the accounts of foreigners so as to guarantee the later availability of funds to satisfy a judgment.<sup>23</sup>

Claims of extraterritorial jurisdiction, it should be noted, do not necessarily insure access to foreign bank records, the real goal of anti-terrorist money laundering enforcement. More problematically, these provisions exclude from coverage those foreign individuals engaged in promoting "specified unlawful activities" (terrorism) and who have financial assets within the United States, but who do not engage in financial transactions in the United States directly relating to those criminal activities. If the United States can prove that an offshore corporation

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<sup>22</sup> 18 USC §1956(c)(3), (4) and (5).

<sup>23</sup> 18 USC §1956(b)(2) and (3).

with a bank account in the United States is used to provide revenues for terrorist activities, it seems absurd that the money laundering statute should not provide authority for the seizure of those assets, whether or not the offshore corporation is a financial institution.

Three aspects of these anti-money laundering rules are vitally important to recognize. First, these are the only two provisions of US anti-money laundering legislation which do not require proof that the money being transferred represents the proceeds of a crime. All other legislation currently existing is essentially informed by and structured to meet the demands of counter-narcotics operations.<sup>24</sup> Other provisions exist which impact the ability of individuals and organizations to engage in financial transaction with regard to terrorist activities, but the money laundering statutes are law enforcement agencies' primary financial weapon.

Second, these provisions apply only to cross-border movements of funds – they do not apply to financial transactions carried out solely within the United States, or entirely outside its borders.<sup>25</sup> A strong case can be made that both limitations could be removed. There seems to be little reason not to extend the provisions of §1956 to transfers carried out solely within the United States.

Third, they apply to “specified unlawful activities” carried out outside the United States only if that activity flows through traditional financial systems. It would seem reasonable to expand the scope of §1956 to include all transactions which impact commerce within the United States – thus capturing transfers of funds through non-traditional financial systems such as Hawala. There is no

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<sup>24</sup> Cf. 18 USC 1957, making it illegal to transfer into or out of the country more than \$10,000 in criminal proceeds. The enactment of this provision was a significant achievement for drug enforcement authorities, but does little for counter-terrorism.

<sup>25</sup> See Stefan D. Cassella, “Money laundering has gone global: It’s time to update the Federal laws,” Federal Lawyer, No. 49 (January, 2002) 25, 30.

good reason to exempt the least-regulated aspects of the financial system from the money laundering regulations.

One remaining loophole was addressed by the newly-enacted 31 USC §5332, included by Congress in the USA Patriot Act of 2001, making it a crime to smuggle large amounts of cash across the US border, regardless of the origins of that money:

Whoever, with the intent to evade a currency reporting requirement under section 5316, knowingly conceals more than \$10,000 in currency or other monetary instruments on the person of such individual or in any conveyance, article of luggage, merchandise, or other container, and transports or transfers or attempts to transport or transfer such currency or monetary instruments from a place within the United States to a place outside of the United States, or from a place outside the United States to a place within the United States, shall be guilty of a currency smuggling offense...<sup>26</sup>

It should be noted, however, that as with §1956, §5332 applies only to movements of large amounts of cash across the national borders of the United States. It is not clear why similar movements of cash within the United States pose less of a threat to national security, if they are intended to further terrorist activity. Currently, the terrorist's accomplice with \$15,000 cash stopped on the Canadian border by an agent of the Immigration and Naturalization Service would be arrested and imprisoned, whereas the same individual arrested on his way from New Jersey to Florida would have violated no law, and reason would dictate that §5332 be amended to apply equally to both situations.

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<sup>26</sup> 31 USC §5332(a)(1). 31 USC §5316, to which §5332 refers, requires the filing of a report with the Treasury Department for cross border movements of amounts greater than \$10,000; §5332 essentially criminalizes the failure to file such reports, and thereby makes confiscation of the smuggled cash easier. 31 USC §5317 authorizes courts to issue search warrants to enforce §5316 reporting, and permits the seizure of smuggled funds.

*Tracing terrorist assets*

The principal record-keeping and reporting provisions pertinent to the anti-terrorist campaign are found in 31 USC §5311 et seq. The following discussion focuses on the requirements imposed by these provisions, and their applicability to the war on terror. That these measures were specifically intended by Congress to respond to the needs of anti-terror investigators is made clear at the outset: “It is the purpose of this subchapter...to require certain reports or records where they have a high degree of usefulness in...in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.”<sup>27</sup>

These reporting provisions apply, in theory, to a very broad class of financial institutions within the United States, including traditional financial actors (banks, thrifts, insurance companies, broker-dealers, currency exchanges, etc.) as well as institutions less commonly considered as ‘financial institutions’ (casinos, telegraph companies, real estate agents, vehicle retailers, and the United States Postal Service).<sup>28</sup>

Significantly for anti-terror investigators, non-traditional money transfer agents would seem to be covered by this legislation but explicitly exempted from many of its reporting requirements. The definition of ‘financial institution’ includes any “licensed sender of money or any other person who engages as a business in the transmission of funds, *including any person who engages as a business in an informal money transfer system or any network of people who engage as a business in facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system.*”<sup>29</sup> In addition, the Secretary of the Treasury is authorized to add to the list of defined ‘financial institutions’ any type of business which is

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<sup>27</sup> 31 USC §5311.

<sup>28</sup> 31 USC §5312(a)(2).

“similar to, related to, or a substitute for” a listed institution, or whose cash transactions would be useful for investigators.<sup>30</sup> This definition thus seems a model of breadth of coverage, though many of the defined “financial institutions” are not in fact bound by some of the standard reporting requirements.

### *Currency reporting*

The heart of the reporting requirements are found in §5313, authorizing the Treasury to require depository institutions to report to regulators all domestic currency transactions above a certain threshold level (currently \$10,000). Exemptions from reporting requirements are granted for transactions respecting the accounts of other depository institutions, and for established, legitimate business clients of the depository institution.<sup>31</sup> It should be noted that the reporting requirements of §5313 apply only to ‘depository institutions’, and not to the entire list of ‘financial institutions’ contained in §5312 – a significant reduction in the scope of the provisions’ applicability. Similar reporting requirements for foreign currency transactions are authorized in §5315, and interestingly are expanded to apply to non-depository businesses.<sup>32</sup> The Treasury is directed to make currency transaction reports available to other law enforcement and intelligence agencies, and compliance with the reporting requirements is backed up by the possibility of both civil and criminal penalties.

Deliberately structuring transactions so as to slip beneath the reporting threshold (“smurfing,” in the lingo of drug enforcement officials) is prohibited.<sup>33</sup> Stiff penalties also exist for any individual or organization who knowingly and willfully, in “any matter within the jurisdiction” of

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<sup>29</sup> 31 USC §5312(a)(2)(R), emphasis added.

<sup>30</sup> 31 USC §5312(a)(2)(Y) and (Z).

<sup>31</sup> 31 USC §5313(a), (d) and (e).

<sup>32</sup> 31 USC §5315(a).

the US Government (i) falsifies or conceals a material fact, (ii) makes a false or fraudulent statement, or (iii) uses falsified documents.<sup>34</sup> This is a fairly broad provision, and exemptions in sub-sections (b) and (c) make it clear that the purpose of the section is to enforce truthful cooperation with regulatory investigations and Congressional inquiries – the section does not apply to court proceedings. The jurisdictional definition, however, may prevent extraterritorial application, and thus limit its effectiveness against correspondent banks carrying on business with, but not inside, the United States.

### *Record keeping*

If it feels it necessary, the Treasury may require even non-financial firms located within or doing business within the United States to maintain records describing their financial transactions with foreign parties, including records detailing the identity and address of participants in a transaction or relationship, the legal capacity in which a participant is acting, the identity of real parties in interest, and a description of the transaction.<sup>35</sup> The Treasury may conduct examinations of these records, and may require financial institutions and other businesses to appear with documentary evidence regarding the regulated transactions.<sup>36</sup>

Implementation of such requirements, however, would be practically impossible. It seems unlikely that any businesses would necessarily be able to supply all the authorized information without catastrophic burden on the commercial system, even if they attempted to comply in good faith. Congress seems to have recognized this inherent limitation, and part of the legislative response to the September 11<sup>th</sup> attacks was a Congressional request that the Treasury Department

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<sup>33</sup> 31 USC §§ 5319, 5321, 5322, and 5324.

<sup>34</sup> 18 USC §1001(a). See 18 USC §3571 for the applicable fines for individuals and for organizations; individuals may also be subject to up to five years imprisonment for violations.

<sup>35</sup> 31 USC §5314(a)(1), (2), (3) and (4).



“study methods for improving compliance” with these reporting guidelines.<sup>37</sup> The concept of studying the issue is worthwhile, and statutory authority providing for broad regulatory powers is always appreciated by regulators. The problem remains, however, that the volume of transactions carried out by US business is simply too large to be usefully recorded in the depth provided for by law, and a focus on record keeping by financial institutions alone (rather than all commercial firms) is almost certainly preferable except in certain narrowly defined cases where particular countries or regions are known to be especially suspect.

*“Special measures”*

The concept of focusing attention on particularly suspicious countries, however, was adopted by Congress in one of several direct responses to September 11<sup>th</sup>, the newly enacted §5318A.<sup>38</sup> Because this provision was devised specifically to respond to terrorists’ use of the US financial system, it is worth examining in detail. In broad outline, §5318A authorizes the Treasury to designate certain jurisdictions, institutions, or types of transactions as posing particular threats for anti-money laundering investigations, and to therefore require financial institutions to take additional steps to monitor transactions involving those countries or organizations, including heightened reporting and record keeping. At the extreme, the Treasury is permitted to exclude entirely certain correspondent accounts from the US financial system. Additional record keeping and reporting rules may be mandated by executive order; prohibitions on classes of correspondent accounts may be imposed only through the process for promulgating regulations.

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<sup>36</sup> 31 USC §5318.

<sup>37</sup> Pub.L. 107-56, Title III, § 361(b), Oct. 26, 2001, 115 Stat. 332.

<sup>38</sup> Pub.L. 107-56, Title III, § 311, Oct. 26, 2001: “Special Measures for Jurisdictions, Financial Institutions, or International Transactions of Primary Money Laundering Concern.”

The provisions of §5318A swing into action if the Secretary of the Treasury, in consultation with the Secretary of State and the Attorney General, determines that a foreign jurisdiction, a foreign financial institution, or particular types of transactions or accounts are “of primary money laundering concern.”<sup>39</sup> Factors to be specifically considered in making this determination include, for foreign jurisdictions,

- evidence of terrorist activity in that jurisdiction,
- bank secrecy provisions, and similar benefits for non-residents,
- quality of bank supervision,
- imbalances between the volume of financial transactions and the real economy,
- designations of the jurisdiction as an ‘offshore haven’ by international experts,<sup>40</sup>
- previous US experiences dealing with regulators in that jurisdiction, and
- prevalence of corruption in that country.<sup>41</sup>

For foreign institutions and types of transactions, the criteria are similar, and similarly broad:

- whether the institution or transaction is commonly used to facilitate money laundering,
- whether that type of transaction has any legitimate purpose, and
- whether the proposed regulatory action will “continue...to guard against international money laundering.”<sup>42</sup>

It seems clear that Congress intended this section to be invoked essentially at the discretion of the Treasury, with perhaps a nod in the direction of international politesse (the State Department) or law enforcement exigencies (the Justice Department). The provision provides a true blank check.

Once the Treasury has determined that a particular jurisdiction, institution, or type of transaction poses a special threat, several different types of “special measures” may be required. It should be noted that while standard currency reporting and record keeping requirements are limited to

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<sup>39</sup> 31 USC §5318A(c)(1).

<sup>40</sup> This represents a true tie-in with the Financial Asset Task Force at the OECD: a designation of a jurisdiction as “non-cooperating” under FATF guidelines might trigger increased scrutiny or even prohibition of transactions with that jurisdiction by the Treasury.

<sup>41</sup> 31 USC §5318A(c)(2)(A).

<sup>42</sup> 31 USC §5318A(c)(2)(B).

depository institutions, “special measures” may be required of all domestic financial institutions, and hence apply quite broadly.<sup>43</sup>

First, record keeping and reporting obligations may be imposed, including disclosure of the identity and address of the originator, the legal capacity in which a participant in any transaction is acting, a description of the transaction, and (most importantly) identify the beneficial owner of the funds involved in the transaction.<sup>44</sup> It is not clear how great a burden these record keeping requirements will be for banks but they are almost certainly less than the value to law enforcement agencies: such records are exactly the type of information which makes reverse tracing possible. It should be noted that for many types of institutions, particularly non-depository ones, records maintained under “special measures” would be the only mandated record of international transactions available.

Second, the Treasury may impose identification requirements related to non-transparent foreign transactions and organizations:

- Financial institutions may be required to ascertain the beneficial ownership of any account opened in the United States by a foreign entity (except for publicly traded corporations).<sup>45</sup>
- Financial institutions maintaining payable-through accounts or correspondent accounts may be required to identify each customer (and customer’s representative) permitted to use the account, or whose transactions are routed through the account, and to obtain all the information that would be typically be obtained about a customer located in the United States (‘Know Your Customer’ rules).<sup>46</sup>

Finally, through the formal process of promulgating a regulation (and after consultation not only with the Departments of State and Justice, but also with the Federal Reserve), the Treasury may prohibit entirely the opening or maintaining of payable-through or correspondent accounts

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<sup>43</sup> 31 USC §5318A(b)(1)(A).

<sup>44</sup> 31 USC §5318A(b)(1)(A).

<sup>45</sup> 31 USC §5318A(b)(2).

<sup>46</sup> 31 USC §5318A(b)(3) and (4).

originating in particular jurisdictions or with particular institutions, or involving particular classes of transactions.<sup>47</sup>

These provisions, taken together, close a major loophole in the US anti-money laundering defenses. Used to their fullest extent, they give the Treasury Department the formal power to require disclosure of beneficial ownership of foreign-owned financial flows in a way previously unknown. In addition, the mere threat of invoking these rules should provide an extremely powerful lever with which the Treasury can motivate foreign governments to cooperate with American surveillance and investigations. No foreign government would wish to be designated for “special measures,” and the threat of prohibiting correspondent accounts would be devastating. No foreign financial system could function adequately without strong links to the US banking system, and these provisions increase dramatically the Treasury’s ability to encourage cooperation abroad.

#### *Shell banks and correspondent accounts*

Two further provisions deserve comment at this point, impacting as they do the ability of foreign entities to maintain anonymous accounts in the United States. The first involves offshore shell banks, and the second involves correspondent accounts and private banking. Both these measures were enacted as part of the USA Patriot Act, the legislative response to the violence of September 11<sup>th</sup>, though both represent proposals which had been on the table for some years previously.

First, Congress moved to abolish correspondent accounts on offshore shell banks. Pursuant to the new §5318(j), “covered financial institutions”<sup>48</sup> in the US are prohibited from holding a

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<sup>47</sup> 31 USC §5318A(b)(5)

correspondent account for any bank that has no physical presence in any country, and must take reasonable steps (as specified by regulation) to prohibit correspondent foreign banks from themselves using their correspondent accounts for the benefit of such shell banks.<sup>49</sup> The statute provides an exception for shell banks created and regulated by legitimate banks resident in the US or abroad.<sup>50</sup>

This is an obviously important and long-overdue law enforcement measure. Shell banks have traditionally posed great challenges to regulatory authorities, as they have existed outside the sphere of meaningful regulation and have essentially operated anonymously. The difficulty with this provision will come through enforcement: how can American regulators assure that legitimate foreign banks are scrupulously prohibiting offshore shell banks from using their correspondent facilities in the United States? There will probably be no complete solution to this problem, but the enactment of §5318A is certainly a help: non-cooperating foreign banks face the possibility of being singled out for “special measures,” with the increased reporting burdens, information disclosure, and commercial stigma those measures would entail. The threat of such regulatory action should create strong incentives for legitimate foreign banks to self-regulate as regards prohibited shell bank accounts.

Second, Congress enacted stiffer due diligence requirements for banks operating private or correspondent banking accounts for foreign entities. Under the new §5318(i), due to take effect 270 days after October 26, 2001 (near the end of August, 2002) all financial institutions are

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<sup>48</sup> A “covered financial institution” is defined to include an insured bank, a commercial bank or trust company, a private banker, an agency or branch of a foreign bank in the United States, any credit union, a thrift institution, or a registered broker or dealer. The definition does not include insurance companies or other “financial institutions” as defined by 31 USC §5312. See 31 USC §5318(j)(1).

<sup>49</sup> 31 USC §5318(j)(1) and (2).

<sup>50</sup> 31 USC §5318(j)(3).

required to maintain “appropriate” and “specific” due diligence procedures to detect money laundering activity carried out through private or correspondent accounts.<sup>51</sup> At a minimum, banks maintaining private banking accounts for foreign entities must identify the nominal and beneficial owners of the funds in the account, and the source of those funds. The bank must also maintain close scrutiny of any accounts linked to high government officials who may be attempting to dispose of the proceeds of corruption.<sup>52</sup>

Certain private and correspondent accounts, however, are to receive “enhanced” or “additional” controls. These stricter procedures apply to all correspondent accounts maintained by (i) an offshore bank, (ii) a foreign bank from a jurisdiction designated as “noncooperative” in anti-money laundering efforts by an intergovernmental agency, or (iii) a foreign bank from a jurisdiction singled out for “special measures” under §5318A.<sup>53</sup> For these accounts, the bank must

- identify the owners of the foreign bank (if it is not a publicly traded entity, as most are not),
- conduct additional scrutiny of the account, and report any suspicious transactions, and
- ascertain whether that bank maintains other correspondent accounts, and if so, identify the location and nature of those other accounts.<sup>54</sup>

This provision essentially requires US banks to directly assist law enforcement agencies in their attempt to collect financial intelligence. In order to maintain this class of (lucrative) accounts – private and offshore correspondent accounts – the American bank must agree to assist in documenting transactions which have historically been the favorite mode for transferring illicit money across international borders.

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<sup>51</sup> 31 USC §5318(i)(1).

<sup>52</sup> 31 USC §5318(i)(3).

<sup>53</sup> 31 USC §5318(i)(2).

<sup>54</sup> 31 USC §5318(i)(2)(B).

*Suspicious Activity Reports*

In addition, §5318 requires financial institutions to report to the Treasury “any suspicious transaction relevant to a possible violation of law or regulation.”<sup>55</sup> This seemingly broad and innocuous provision has actually given rise to one of the more successful anti-money laundering procedures, the “Suspicious Activity Report” (SAR). SARs may be directed by the financial institution to one of a number of law enforcement organizations. Bank employees are prohibited from ‘tipping’ the account-holder that the SAR has been filed (otherwise the tippee would rapidly empty the account), and the financial institution may not be held liable by the account-holder for the disclosure of confidential information through the SAR.<sup>56</sup>

SARs impact very broadly on the financial community: in October of 2001, Congress instructed the Treasury to extend SAR reporting to securities brokers and dealers, authorized SARs for commodities trading advisors, commissioned a Treasury study of SARs for investment companies, and added language to §5318 extending SAR applicability to non-traditional money exchange businesses.<sup>57</sup> According to a joint Treasury/industry report, SAR filings totaled 162,714 in the year 2000, and were on course for a record number in 2001.<sup>58</sup> The Egmont Group, an intergovernmental consortium of financial regulatory authorities, recently released a massive study of successful financial crime prosecutions, the majority of which were assisted, if not enabled, by SARs (or their equivalents abroad). While the majority of SARs have historically corresponded to drug activity or other crimes, September 11<sup>th</sup> has undoubtedly changed the awareness of bank personnel, and SARs will in the future hopefully be as effective for anti-terrorism efforts as they have been for the anti-narcotics and anti-fraud investigators.

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<sup>55</sup> 31 USC §5318(g)(1).

<sup>56</sup> 31 USC §5318(g)(2) and (3).

<sup>57</sup> Pub.L. 107-56, Title III, §§ 356 and 359, Oct. 26, 2001.

*Conclusion*

Legislation authorizing tracing of foreign terrorist assets at the US border is thorough. Cash carried across the frontier in bulk must be disclosed and documented. Cash transactions facilitated by banks, either in domestic or foreign currency, which exceed certain limits must be reported and recorded. All transactions involving foreign shell banks are prohibited, and foreign correspondent banks and foreign private banking transactions are subject to especial scrutiny and verification. Foreign banks or foreign financial jurisdictions which pose particular problems may be singled out by regulators for closer supervision, and entire classes of transactions with foreign institutions may be prohibited.

The problem areas for asset tracing are therefore those transactions which escape the border controls: transactions carried on entirely inside the United States, carried out entirely abroad, or carried out surreptitiously through informal channels which evade regulatory enforcement altogether. Potential means of addressing these challenges are discussing in Chapter 5.

**Institutions and enforcement**

This section examines the US governmental agencies which have responsibility for implementing the asset tracing provisions discussed above. The system of control over financial institutions is extremely complex even for prudential regulatory matters alone, and the addition of law enforcement objectives to the mixture only complicates the lines of communications and increases the area of overlapping competencies.

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<sup>58</sup> The Bank Secrecy Act Advisory Group, The SAR Activity Review: Trends, Tips & Issues,



*Law enforcement and intelligence agencies*

The Department of the Treasury (DOJ) and the Federal Bureau of Investigation (FBI) have primary jurisdiction over all investigations relating to terrorism, including the financing of terrorism.<sup>59</sup> Within the FBI, three sub-units seem relevant to the current discussion. The Counterterrorism Division and Financial Crimes Section both existed previous to September 11<sup>th</sup>; within the Financial Crimes Section, the Money Laundering Unit has traditionally focused on illicit movements of criminal funds.

In addition, after the attacks the DOJ and FBI jointly created the Financial Resources Group (FRG). The FRG brings together law enforcement and intelligence resources from across the Federal government, including the Central Intelligence Agency (CIA),<sup>60</sup> the National Security Agency (NSA), the Defense Intelligence Agency (DIA), the Drug Enforcement Agency (DEA), the U.S Postal Inspection Service, the National Drug Intelligence Center, the Federal Reserve, the Inspector General Community and several different branches of the Department of the Treasury, including the U.S. Customs Service, Internal Revenue Service (IRS), Bureau of Alcohol, Tobacco and Firearms (ATF), Office of Foreign Asset Control (OFAC), the United States Secret Service, and the Financial Crimes Enforcement Network (FinCEN). The FRG supports the ongoing work of the Counterterrorism Division, and its mandate has evolved from investigating solely the events of September 11<sup>th</sup> to a broader program of disrupting and monitoring all flows of finance to terrorist organizations worldwide.<sup>61</sup>

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Issue 3 (Washington, D.C.: BSAAG, October 2001) 5.

<sup>59</sup> Dennis Lormel, *ibid.*

<sup>60</sup> The CIA maintains its own financial monitoring activities through the Directorate of Intelligence, probably within the Office of Transnational Issues – but this structure is difficult to confirm or evaluate given the confidential information involved.

<sup>61</sup> Dennis Lormel, *ibid.*

In contrast – if not opposition – to the law enforcement focus of the DOJ and FBI, the Department of the Treasury bears primary responsibility for establishing and monitoring much of the permanent financial infrastructure. In particular, the Treasury is designated as the key decision-maker in most of the asset tracing legislation. Within the Treasury, several sub-divisions deserve particular attention.

The Financial Crimes Enforcement Network (FinCEN) was established as a bureau of the Treasury by the Bank Secrecy Act in 1990. Its mission is to support law enforcement authorities at every level, from local to international, through analysis of SARs and other required financial reporting. FinCEN establishes and monitors the regulations regarding record-keeping and reporting, and coordinates information sharing between agencies. FinCEN is comprised of roughly 200 full-time Treasury employees, intelligence specialists, and financial analysts.<sup>62</sup>

FinCEN represents the United States internationally as a member of two important intergovernmental entities, which will be discussed more fully in the following chapter. The Egmont Group is comprised of national Financial Intelligence Unites (FIUs) and works to foster information sharing and support the exchange of financial intelligence. The Financial Action Task Force (FATF) is a plurilateral organization promoting standards and best-practices to combat global money laundering.

Also within the Treasury Department is the Office of Foreign Asset Control (OFAC). Dating back to the Trading With the Enemy Act of the First World War, OFAC has responsibility for implementing asset seizure orders and embargoes within the United States. Legislation within the jurisdiction of OFAC which contains significant anti-terrorist provisions include:

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<sup>62</sup> See [www.ustreas.gov/fincen/le\\_main.html](http://www.ustreas.gov/fincen/le_main.html).

- the International Emergency Economic Powers Act,
- the Iraqi Sanctions Act,
- the Trading with the Enemy Act,
- the United Nations Participation Act
- the International Security and Development Cooperation Act, and
- the Antiterrorism and Effective Death Penalty Act.<sup>63</sup>

Regarding asset tracing – as opposed to asset seizure – OFAC exercises a reporting function.

Under the Antiterrorism and Effective Death Penalty Act,<sup>64</sup> the assets of organizations designated as “Foreign Terrorist Organizations” must be immediately frozen by all financial institutions, and OFAC must be notified of frozen assets within ten days of blocking.<sup>65</sup> OFAC also administers the newly established Financial Institutions Hotline, intended to be used by financial institutions to voluntarily report potential terrorist-related financial transactions.<sup>66</sup>

While this paper does not intend to deal extensively with the mechanics of asset seizure, it should be noted that OFAC is the principal governmental representative within the US and abroad for seizure actions. OFAC creates and administers the regulations for blocking terrorist assets in US banks, and authorizes general and specific licenses for operations relating to blocked accounts. OFAC oversees the Specially Designated National and Blocked Persons list, which includes individuals and organizations whose assets in the US are blocked because of their association with terrorism.<sup>67</sup> Most recently, OFAC has administered Executive Order 13224, President George W. Bush’s order of September 24<sup>th</sup>, 2001, blocking the assets of individuals and

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<sup>63</sup> See Department of the Treasury, OFAC, Foreign Assets Control Regulations for the Financial Community (Washington, D.C.: Dept. of the Treasury, January 2002) 2.

<sup>64</sup> [Give USC cite]

<sup>65</sup> See Department of the Treasury, OFAC, Foreign Assets Control Regulations for the Financial Community (Washington, D.C.: Dept. of the Treasury, January 2002) 19.

<sup>66</sup> Department of the Treasury, FinCEN, “Treasury Establishes Financial Institutions Hotline,” press release, [www.ustreas.gov/fincen/hotlineterrorist.html](http://www.ustreas.gov/fincen/hotlineterrorist.html), October 11, 2001.

<sup>67</sup> For details, see Terrorism Sanctions Regulations (31 CFR Part 595), Terrorism List Governments Sanctions Regulations (31 CFR Part 596), and Foreign Terrorist Organizations Sanctions Regulations (31 CFR Part 597).

organizations believed to have links to terrorists threatening the United States in the wake of September 11<sup>th</sup>.

The principal Treasury task-force for coordinating anti-terrorist efforts seems to be Operation Green Quest, an inter-agency coordinating body established on October 25, 2001, and comprising investigators from the Customs Service, IRS, FinCEN, OFAC, and the Secret Service.<sup>68</sup> The command center for Green Quest, based in the headquarters of the Customs Service, currently has roughly 30 full-time officers. It is still unclear whether this unit will actually craft policy and coordinate investigations or, like the Office of Homeland Defense, will serve primarily as an information exchange and clearing house for financial intelligence data. – though the latter option seems most likely.<sup>69</sup>

#### *Prudential regulation authorities*

Quite significantly, given the breadth of other agencies' participation, throughout the task-forces being established for the anti-terror campaign the federal offices responsible for prudential regulation of banks and other financial institutions seem to have taken a back seat to law enforcement officials. Operation Green Quest, while based in the Treasury Department, does not seem to incorporate staff from the Office of the Comptroller of the Currency (OCC), the statutory oversight authority for national banks. Federal Reserve employees are listed among the fourteen separate Federal agencies participating in the FRG, but the balance of those institutional

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<sup>68</sup> Shortly after September 11<sup>th</sup>, the Treasury announced the establishment of a Foreign Terrorist Asset Tracking Center (FTAT). This term seems to have dropped out of service, and FTAT may now have been subsumed into Green Quest, as would be reasonable given the overlap in their publicly announced responsibilities. See remarks by President George W. Bush, September 24<sup>th</sup>, 2001, [www.whitehouse.gov](http://www.whitehouse.gov).

<sup>69</sup> Dean Boyd, Office of Public Affairs, US Customs Service, "Operation Green Quest Targets Terrorist Finances," press release, [www.customs.ustreas.gov/custoday/nov2001/quest.htm](http://www.customs.ustreas.gov/custoday/nov2001/quest.htm), November 2001.

representatives are law enforcement personnel or intelligence specialists. There is no mention in the Treasury's anti-terrorism literature of the FDIC (front-line regulator for many state banks), the state insurance commissioners, the SEC, or the CFTC, much less the financial institutions' self-regulatory organizations such as the NASD. The absence of prudential regulators on these 'org charts' is glaring.

The lack of these agencies from the institutional structure of the anti-terror effort is not coincidental. The approach of both the executive branch and Congress has been oriented toward two responses: first military and then, secondarily, law enforcement: locate the evil-doers and bring 'em to justice – dead or alive. This is not a bad response; in fact, in the immediate aftermath of the attacks, it was undoubtedly the only response that the American public would have accepted.

The imbalance between law enforcement and prudential regulators, however, may create longer-term difficulties. The regulators have two great institutional strengths. First, from years of hands-on experience with financial investigation, they have a granular and detailed knowledge of the functioning of banking transactions. While experienced investigators in other agencies doubtless have a sophisticated understanding of particular types of transactions, bank regulatory agencies possess a panorama of the financial sector that organizations focused primarily on criminal activities lack.

Second, though not known for soft-heartedness toward their regulatees, the prudential regulators have a sound understanding of the burden to the regulated of additional regulatory burdens. No system of enhanced reporting, mandatory record-keeping, and strengthened customer verification standards is costless. Banks, insurance companies, stock brokers, and other firms must pay to put these measures in place and pay to maintain and evaluate them. While most – perhaps all – the

legislation enacted to date serves extremely worthwhile law enforcement purposes, and will contribute significantly to the national security, it is striking that regulations effecting thousands of financial institutions are currently being debated with only tangential input from the organizations best suited to speak to those measures' operational cost. Trained and experienced law enforcement and intelligence officials should be able to determine the benefit of a proposed tightening of the financial regulations – it makes sense that the costs of that tightening be evaluated equally. A rational policy analysis in this situation would seem to demand a seat for the regulators at the anti-terror war council.

#### CHAPTER 4: THE INTERNATIONAL ARENA

As demonstrated in the previous chapter, American legislation provides governmental investigators with most of the tools needed to track funds which enter the US from abroad, or which are sent overseas from US territory. Certain rules could be changed, particular provisions could be strengthened, and modifications will always be desired simply to keep up with the ingenuity of terrorists seeking new means of avoiding surveillance. A more pressing issue, however, arises for officials attempting to trace money outside the jurisdiction of the United States.

The main difficulty, clearly, stems from the fact that US regulators do not generally have direct access to the records of foreign financial institutions, and depend upon the political and legal cooperation of foreign governments – both politicians and bureaucracies – to continue the search for assets beyond the border. Moreover, this assistance must be rapid enough that the money doesn't escape in the meantime.

News reports indicate that these concerns are not merely academic, and not all of the problems arise in under-regulated backwaters or in states fundamentally hostile to US interests. In the aftermath of September 11<sup>th</sup>, France froze Euro 4.27 million belonging to Osama bin Laden and other organizations designated by the United States as involved in terrorism.<sup>70</sup> German Chancellor Gerhard Schröder has called for revisions in Germany's bank secrecy laws to prevent abuse by terrorist organizations, and Britain has been accused of devoting far too few resources to

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<sup>70</sup> See Le Monde, "Attentats: Paris a gelé des comptes afghans suspects," September 25, 2001.

investigating suspicious activity reports associated with terrorist funds transferred through the City of London.<sup>71</sup>

This section discusses the American approach to the tracing of money beyond the US frontier. Two primary factors are analyzed below: the intergovernmental organizations and agreements which shape the contours of international cooperation on financial anti-terrorism, and the bilateral or unilateral steps the US government has taken to supplement those broader commitments. The conclusion of this analysis is that while efforts to set international standards and harmonize procedures are useful, American success will depend more heavily on foreign states' voluntary cooperation than on formal legal mechanisms for cross-border interaction.

### **The international organizations**

#### *The United Nations*

On September 28<sup>th</sup>, two weeks after the attacks, the Security Council of the United Nations adopted Resolution 1373. This resolution was enacted under Chapter VII of the UN Charter, an unusual and significant step: resolutions adopted under Chapter VII, authorizing the Security Council to take measures "to maintain or restore international peace and security," are immediately binding upon all UN members.<sup>72</sup>

Pursuant to Resolution 1373, member states are required to conform to four principal requirements:

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<sup>71</sup> See Frankfurter Allgemeine Zeitung, "Bank Secrecy Laws to be Loosened in Anti-Terror Effort," September 26<sup>th</sup>, 2001; Le Monde, "Londres accusé de laxisme dans la lutte antiblanchiment," October 10, 2001.



- criminalize willful provision or collection of funds with the intent or knowledge that they will be used for terrorist attacks,<sup>73</sup>
- freeze assets of terrorists, entities owned, controlled by or acting on behalf of terrorists, and funds derived from property owned or controlled by such persons or associated persons,<sup>74</sup>
- prohibit the provision of assets or economic resources, or any type of financial services to terrorists and persons owned, controlled by or acting on behalf of terrorists,<sup>75</sup> and
- cooperate in criminal investigations, “including assistance in obtaining evidence.”<sup>76</sup>

The Resolution establishes a Special Committee to oversee states’ compliance with the provisions outlined above, calls on all member nations to intensify the exchange of intelligence data relating to terrorist activities, and requires all states to report to the Committee on their progress in implementing the Resolution within 90 days.<sup>77</sup>

Four months later, the Security Council followed up its September declaration with Resolution 1390, which essentially establishes an international embargo on financial, military, political, or any other form of aid to Osama bin Laden, Al Qaeda, or the Taliban. Though a heartwarming display of support, certainly, the legal ramifications of this move are limited. The Special Committee created under Resolution 1373, however, is charged with reporting on states’ adherence to the new embargo provisions.<sup>78</sup>

Technically, Resolution 1373 empowers the Security Council to impose sanctions on states which fail to comply with its mandates. Several important terms, however, are left undefined: “terrorism” and “associated persons.” The failure to identify these terms is a result of political failure, not legal sloppiness – “terrorism” remains a controversial term among many UN

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<sup>72</sup> See Jamie L. Boucher, “Anti-Money Laundering Developments,” U.S. and International Initiatives to Suppress Terrorist Financing, Corporate Law and Practice Course Handbook Series (New York: Practising Law Institute, January 23, 2002) 3.

<sup>73</sup> UN Resolution 1373 (2001) Para. 1(b).

<sup>74</sup> UN Resolution 1373 (2001) Para. 1(c).

<sup>75</sup> UN Resolution 1373 (2001) Para. 1(d).

<sup>76</sup> UN Resolution 1373 (2001) Para. 2(f).

<sup>77</sup> UN Resolution 1373 (2001) Paras. 3(a) and 6.

members.<sup>79</sup> Thus while Resolution 1373 provides an excellent starting point for American financial investigations abroad, it represents more a political than a legal tool.

Prior to September 11<sup>th</sup>, the United Nations had already begun to move forward to combat the financing of terrorism. In 1999, the negotiators concluded and the UN General Assembly approved the International Convention for the Suppression of the Financing of Terrorism. One hundred thirty two states have signed the Convention, though only 24 have actually ratified it.<sup>80</sup> It finally went into effect on April 10<sup>th</sup>, 2002.

The Convention overlaps to some extent with the provisions of Security Council Resolutions 1373 and 1390. At the heart of the Convention is the agreement that all signatories will criminalize the direct or indirect provision of funds for terrorist activities.<sup>81</sup> Technically, the Convention improves on the recent Resolutions by making “terrorism” a defined term: terrorism is any activity defined as terrorism under a state’s bilateral anti-terrorism treaties, or (more significantly) “any other act intended to cause death or serious bodily injury to a civilian, or any other person not taking part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature and context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act.”<sup>82</sup> This definition is sufficiently loose to encompass almost any terrorist activity which the United States government would have an interest in investigating internationally.

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<sup>78</sup> UN Resolution 1390 (2002).

<sup>79</sup> “One man’s terrorist is another man’s freedom fighter” may seem a rather pathetic excuse for ambiguity in the context of September 11<sup>th</sup>, but must be taken more seriously in other situations, particularly regarding the Israeli/Palestinian conflict.

<sup>80</sup> The United States is one of the one hundred eight states who have signed but not yet ratified the Convention, though President Bush has indicated that ratification is now on the agenda.

<sup>81</sup> International Convention for the Suppression of the Financing of Terrorism, Art. 2.

The jurisdictional bounds established by the Convention are surprisingly broad. States are allowed to exert jurisdiction over (i) any financial transaction carried out within its territory or by one of its nationals relating to the financing of terrorism,<sup>83</sup> and (ii) any financial transaction carried out anywhere related to an act of terrorism committed on its territory or against its governmental property anywhere, or intended to compel that government to alter its behavior.<sup>84</sup> These provisions would actually provide the United States with remarkable latitude in claiming extraterritorial jurisdiction over terrorist financing offenses committed abroad, where the underlying terrorist attack was intended to target American interests at home or abroad. Domestic US law might, in fact, prove a more limiting constraint than the terms of the Convention.

The Convention requires that states adopt legislation appropriate for adequate monitoring of their financial systems, including the identification of beneficial account holders, the prohibition of anonymous accounts, mandatory suspicious activity reporting, and reasonable record retention.<sup>85</sup> States are further required to provide each other “the greatest measure of assistance” in locating and freezing terrorist assets, and may not refuse assistance on the grounds of bank secrecy.<sup>86</sup> In effect, the Convention outlaws strict bank secrecy rules – a substantial achievement, were it to become widely adopted.

The true caveat with the Convention of course, is its essentially political rather than legal character. The large number of signatures contrasts sharply with the minuscule number of ratifications – probably a sign that many nations have difficulty reconciling their desire to combat terrorism with their pre-existing legal structures and bank regulations. It is possible to imagine the

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<sup>82</sup> International Convention for the Suppression of the Financing of Terrorism, Art. 2(1)(b).

<sup>83</sup> International Convention for the Suppression of the Financing of Terrorism, Art. 7(1).

<sup>84</sup> International Convention for the Suppression of the Financing of Terrorism, Art. 7(2).

<sup>85</sup> International Convention for the Suppression of the Financing of Terrorism, Art. 18(1).

<sup>86</sup> International Convention for the Suppression of the Financing of Terrorism, Art. 12(1) and (2).

Convention coming into play in a high profile case, where both states have significant political assets at stake and a ‘legal’ solution to the impasse is required. The Convention may even serve a useful purpose as a tool with which American diplomats can encourage other nations to move in the direction of responsible financial self-regulation. For the day-to-day investigative work of tracing small, rapidly moving accounts around the globe, however, the Convention must be recognized as largely symbolic – an agreement which will assist US authorities only if counter-party governments and bureaucracies implement its provisions in true good faith.

### *The Financial Action Task Force*

In 1989, the G-7 Summit in Paris established the Financial Action Task Force on Money Laundering (FATF), with the mandate to examine money laundering techniques and trends, review anti-money laundering procedures at the national and international level, and designate further action that would be needed. Initially, the FATF was comprised of the G-7 states, the European Commission, and eight other countries; since that point, it has expanded to 31 members plus a number of observer governments and regional cooperation organizations. The FATF is domiciled with the OECD in Paris, though it operates outside the OECD system.<sup>87</sup>

The FATF has undertaken four major tasks. First, in April of 1990, it devised and promulgated the Forty Recommendations, which provide a step-by-step guide for the establishment of effective anti-money laundering regulations. Second, the FATF has undertaken reviews of each of its own member states, with the aim of pointing out the aspects of their own systems which were vulnerable to money laundering penetration.<sup>88</sup> Third, at the other end of the spectrum, the

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<sup>87</sup> FATF, “History of the FATF,” [www.oecd.org/fatf/](http://www.oecd.org/fatf/), updated October 30, 2001.

<sup>88</sup> In 1997, the FATF pointed out that while generally tough on anti-money laundering rules, the US had inadequate customer identification and beneficial ownership disclosure requirements, and that non-bank financial institutions were insufficiently regulated to protect against flows of illicit

FATF has begun publishing a list of “non-cooperating countries and territories” (NCCTs) – jurisdictions which posed particular challenges for anti-money laundering surveillance. Finally, , the FATF has expanded its mission and launched an intensive campaign against terrorist financing.<sup>89</sup> These latter two initiatives deserve a more detailed examination.

In February of 2000, the FATF published a list of twenty five criteria which would be used to determine NCCTs, encompassing not only “direct legal or practical impediments” to international anti-money laundering cooperation, but also indirect obstacles “designed to restrict the supervisory powers of the relevant administrative or judicial authorities or the means to exercise these powers.”<sup>90</sup> The criteria according to which NCCTs are designated are:

Loopholes in financial regulation

- No, or inadequate, regulations and supervision of financial institutions,
- Possibility for individuals or legal entities to operate financial institutions without effective authorization or registration,
- Absence of measures to prevent criminals or their confederates from holding controlling positions in financial institutions,
- Existence of anonymous accounts or accounts in obviously fictitious names,
- Lack of effective law and regulations requiring effective identification of beneficial owners of accounts,
- Lack of a legal or regulatory obligation for financial institutions to keep and preserve adequate records,
- Legal or practical obstacles to investigative authorities’ access to account transaction records and information related to beneficial ownership,
- Secrecy provisions which may be invoked against, but not lifted by, administrative or judicial authorities, and
- Absence of a mandatory suspicious activity reporting system, and lack of sanctions for failure to make effective suspicious activity reports.

Obstacles raised by other regulatory requirements

- inadequate commercial law requirements for the registration of business and legal entities,
- obstacles to financial institutions’ attempts to identify beneficial owners of accounts, and

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finance. These short-comings were addressed only after September 11<sup>th</sup>. See FATF, extract from FATF-VIII Annual Report (1996-1997), 19 June 1997), (Paris: FATF, 1997) 14-16.

<sup>89</sup> See FATF, “FATF Cracks Down on Terrorist Financing,” press release (Washington, D.C.: FATF, October 31, 2001).

<sup>90</sup> FATF, Report on Non-Cooperative Countries and Territories (Paris: FATF, 2000) 1.

- systems which allow financial institutions to carry out transactions without knowing the beneficial owner of the assets involved.

#### Obstacles to international cooperation

- Laws or regulations prohibiting international exchange of information, or subjecting exchange of information to unduly cumbersome and restrictive procedures,
- Prohibiting authorities from conducting investigations on behalf of foreign counterparts,
- Obvious unwillingness to respond constructively to requests for assistance, and generally restrictive practices relating to the investigation of suspicious matters,
- Failure to criminalize money laundering, and
- Refusal to provide judicial cooperation with investigations, particularly on the grounds that tax matters might be involved.

#### Inadequate resources

- Failure to provide the administrative and judicial authorities with the necessary financial, human, or technical resources to exercise effective oversight or conduct investigations,
- Inadequate or corrupt professional staff, and
- Lack of a centralized Financial Intelligence Unit for the collection, analysis, and dissemination of relevant information.<sup>91</sup>

As of September 7, 2001, nineteen countries were listed as NCCTs by the FATF.<sup>92</sup> Though the publication of the names of the NCCTs was greeted with considerable commotion in the media, the FATF's members have not yet determined what – if any – sanctions should be applied to the listed jurisdictions.

The NCCT criteria – legal loopholes, regulatory barriers to enforcement, failure to cooperate with international investigations, and administrative incapacity – are very similar to the criteria that the United States would want to examine in devising its own “special measures” designations, and in fact the recent changes to US anti-money laundering legislation recognize this overlap. Under

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<sup>91</sup> FATF, Report on Non-Cooperative Countries and Territories (Paris: FATF, 2000), Annex.

<sup>92</sup> Cook Islands, Dominica, Egypt, Grenada, Guatemala, Hungary, Indonesia, Israel, Lebanon, Marshall Islands, Myanmar, Nauru, Nigeria, Niue, Philippines, Russia, St. Kitts and Nevis, St. Vincent and the Grenadines, and Ukraine. Several other states had been listed as NCCTs in previous reports by the FATF, but were removed from the list after making changes in legislation

§5318A, designation of a jurisdiction as “non-cooperating” by an intergovernmental anti-money laundering organization can qualify that jurisdiction for “special measures” – the entire burdensome litany of additional reporting, verification, and record-keeping requirements.<sup>93</sup> In effect, the Treasury may out-source a bit of its investigative and analysis to the FATF, and depend on the FATF’s judgment.

This symbiosis, however, should not be exaggerated. First, the FATF’s guidelines for designating NCCTs were devised primarily with anti-narcotics and anti-tax evasion operations in mind. Combating terrorist financing, as has been discussed earlier, may differ: the amounts of money involved are smaller, the patterns of financial transactions are reversed, and the types of regulations required are more focused. Factors such as those considered by the Treasury when making a “special measures” determination could be added to the FATF criteria, and would significantly advance the US counter-terrorism effort.

Second, §5318A and the “special measures” provisions are designed to target not only entire countries but also individual institutions, classes of transactions, and types of accounts. While the FATF has published useful information on “typologies of money laundering” which analyze common patterns of money laundering transactions, it has not formally taken a position on whether such problematic transactions should actually be banned or subject to enhanced regulatory scrutiny – this has been left to the judgment of individual states’ regulators.

Third, it should be noted that there is not a great deal of overlap between the nineteen currently designated NCCTs and those jurisdictions which have been repeatedly singled out by various

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and administrative procedures. See FATF, “Updated list of non-cooperative countries and territories,” [www.oecd.org/fatf/](http://www.oecd.org/fatf/), September 27, 2001.

<sup>93</sup> 18 USC §5318A(c)(2)(A).

Administrations for their connection with terrorist financing. President Bush's "axis of evil" – Iraq, Iran, and North Korea – are absent from the list. Of the Middle Eastern states, only three appear – Egypt, Israel, and Lebanon – and Israel at least is likely to cooperate with American anti-terrorist efforts. Thus while the effort to establish a list of non-cooperating jurisdictions is undoubtedly useful, the FATF's listing of NCCTs on the basis of these criteria alone will not replace unilateral American determinations.

The FATF's direct involvement in anti-terrorism stems from October of 2001, when the Plenary Session agreed to a set of Special Recommendations on Terrorist Financing. Similar to the Forty Recommendations on Money Laundering, the Special Recommendations commit member states to:

- ratify and implement all applicable UN instruments,
- criminalize the financing of terrorism and associated money laundering,
- freeze and confiscate terrorist assets,
- report suspicious transactions related to terrorism,
- cooperate with other states' investigations relating to the financing of terrorism,
- eliminate or regulate alternative remittance systems,
- require more complete record-keeping regarding wire transfers, and
- review laws relating to non-profits that may be exploited for terrorist purposes.<sup>94</sup>

Several of these recommendations merely rehash previous FATF injunctions, while others are duplicative of UN mandates – UN Resolution 1373, for instance, requires the freezing of terrorist assets and calls for international cooperation in anti-terrorist financial investigations. The Recommendations relating to alternative remittance systems and wire transfer records, however, are new and significant. Both of these areas pose real problems for US investigative authorities, and substantive international assistance in both of these areas would be of tremendous assistance.

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<sup>94</sup> FATF, "FATF Cracks Down on Terrorist Financing," press release (Washington, D.C.: FATF, October 31, 2001).



Simultaneously with the issuance of the Special Recommendations, the FATF established a work program for future anti-terrorism efforts. This schedule includes self-assessments by FATF members of their own anti-terrorist financing policies, the development of technical guidance for financial institutions on mechanisms used in the financing of terrorism, and a procedure to identify jurisdictions “that lack appropriate measures to combat terrorist financing.”<sup>95</sup>

This last measure is perhaps the most significant of all the FATF proposals. A NCCTs list based on anti-terrorist principles and backed up by the authority of a multilateral organization would have significant international credibility – credibility that the US lacks when acting alone. “Special measures” determinations by the Treasury would flow much more directly from such an ‘anti-terrorism NCCTs’ list than is possible under the current system.

Further, unlike unilateral American action, ‘anti-terrorism NCCT’ determination by the FATF would create the opportunity for coordinated counter-measures by all FATF members – a potentially devastating threat for otherwise recalcitrant countries. While the FATF has not established sanctions against members of the standard NCCTs list, it has been actively considering doing so. And regardless of the action against those countries, the political impetus for action against ‘anti-terrorism NCCTs’ should be much easier to achieve. In this field, therefore, the FATF could play a central role.

### *The Egmont Group*

The Egmont Group was established in 1995 as an informal gathering of Financial Intelligence Units (FIUs) – agencies responsible for collecting, analyzing, and distributing financial data

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<sup>95</sup> Ibid.

relevant to law enforcement and intelligence activities.<sup>96</sup> FIUs “increasingly serve as the focal point for national anti-money laundering programmes because they provide the possibility of rapidly exchanging information (between financial institutions and law enforcement/prosecutorial authorities, as well as between jurisdictions), while protecting the interests of the innocent individuals contained in their data.”<sup>97</sup>

FIUs are a relatively new concept; the first were organized in the early 1990s and the majority have been created within the last five years. Two main factors have been driving this trend. First, many countries’ existing law enforcement frameworks were being overwhelmed by data and were in need of a clearinghouse for financial information. Second, following on the FATF’s Forty Recommendations and other regional initiatives, the concept of suspicious activity reporting became a standard part of most financial regulators’ anti-money laundering efforts. A centralizing office was needed to receive, process, and transmit the information brought in by the new regulations. Over time, FIUs have tended to combine the two functions (law enforcement support and SAR management).<sup>98</sup> The Treasury’s FinCEN is the American FIU and is the US representative to Egmont. There are currently fifty eight FIU members, and more continue to join each year.

The Egmont Group unfortunately seems to represent a laudable ambition, but lacks significant institutional follow-through. This impression may be partially the result of the quasi-confidential nature of its work: the published information concerning Egmont is scarce and opaque. The one

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<sup>96</sup> The technical definition of an FIU, as provided by the Egmont Group, is “a central, national agency responsible for receiving (and, as permitted, requesting), analyzing and disseminating to the competent authorities, disclosures of financial information: (i) concerning suspected proceeds of crime, or (ii) required by national legislation or regulation, in order to counter money laundering.” Egmont Group, “Information Paper on Financial Intelligence Units and the Egmont Group,” [www1.oecd.org/fatf/pdf/EGinfo-web\\_en.pdf](http://www1.oecd.org/fatf/pdf/EGinfo-web_en.pdf), (London: Egmont Group, n.d.) 4.

<sup>97</sup> Ibid. 2.

document created by Egmont which seems to have represented a substantive advance – the “Principles for Information Exchange Between Financial Intelligence Units,” approved by the members in June of 2001 – does not appear to be publicly available.

Nevertheless, the evidence seems to indicate that Egmont has remained at most a forum for fostering interpersonal contacts between FIU administrators, and perhaps for disseminating best-practices tips.<sup>99</sup> FinCEN has traditionally provided staff support to some international training and technical assistance efforts, and Egmont may be an appropriate forum through which some of these resources could be coordinated. The quiescence of the Egmont Group as an institution, however, is unfortunate. The FATF brings together a number of the same international actors (FinCEN is frequently the US representative for FATF discussions as well) but has a different goal: the setting of international standards, rather than the implementation of existing regulations. It would be encouraging for Egmont to develop into an organization with the authority to substantively facilitate inter-agency cooperation on an international level – an Interpol for international financial transactions. It has not yet adopted that role, and real buy-in from a large number of regulatory agencies, in the US and abroad, would be necessary.

### *The International Monetary Fund*

An alternative venue for the coordination of financial information exchange, and for the enforcement of anti-terrorism financial regulations, is the International Monetary Fund (IMF). Alone among the specialist financial institutions discussed so far, the IMF has both near-universal membership and the institutional (and financial) leverage to insure compliance with its programs.

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<sup>98</sup> Ibid. 3.

<sup>99</sup> Indeed, one of the Egmont Group’s few published documents is a large collection of case studies of successful money laundering investigations. Egmont Group, FIU’s in Action: 100 Cases from the Egmont Group (London: Egmont Group, 2000).

With both of these attributes, however, come a high degree of bureaucratic inertia and a reluctance to engage in new, ‘off-mission’ activities.

In 1999, the IMF and the World Bank jointly initiated the Financial Sector Assessment Program (FSAP). The purpose of the FSAP has been to administer expert assessments of individual countries’ financial systems, attempting “to identify the strengths and vulnerabilities of a country's financial system; to determine how key sources of risk are being managed; to ascertain the sector's developmental and technical assistance needs; and to help prioritize policy responses.”<sup>100</sup> Put more simply, the IMF examines the financial systems of voluntary participants and publishes reports pointing out problems.

The standards actually applied by the IMF assessments are largely drawn from outside expert organizations: the World Bank, the International Accounting Standards Board, the International Federation of Accountants, the Basel Committee on Bank Supervision, the UN Commission on International Trade Law, the International Bar Association, the OECD, the International Association of Insurance Supervisors, the International Organization of Securities Commissioners, the Committee on Payments and Settlements Systems, and the Institute for International Finance.<sup>101</sup>

Among other initiatives associated with the FSAP, the IMF’s Executive board has launched a campaign to improve the regulation of Offshore Financial Centers – clearly a valuable

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<sup>100</sup> IMF, “Financial Sector Assessment Program,” [www.imf.org/external/np/fsap/fsap.asp](http://www.imf.org/external/np/fsap/fsap.asp) (Washington, D.C.: IMF, 2002).

<sup>101</sup> IMF, “Standard Setting Agencies,” [www.imf.org/external/standards/agency.htm](http://www.imf.org/external/standards/agency.htm) (Washington, D.C.: IMF, 2002).

contribution to the anti-terrorist financing effort.<sup>102</sup> The Financial Stability Forum, an inter-governmental consortium of financial regulators, has noted the potential impact of the IMF's FSAP efforts on terrorist financing, and has endorsed the FATF's Special Recommendations.<sup>103</sup> In theory, it should be a short step from this point to formal integration of the FATF provisions – the Special Recommendations on terrorist financing even if not all of the Forty Recommendations on money laundering – into the formal FSAP review structure.

Such integration would have massive benefits. The IMF has global reach, and far more resources, financial, technical, and in terms of skilled personnel, than any other international organization currently involved in the anti-terrorism campaign – certainly more than the FATF can muster on its own. The IMF already disposes of experienced financial regulators, and can more easily balance prudential and anti-terrorist regulatory concerns than can an organization such as the Egmont Group, with its primary focus on law enforcement. An IMF evaluation of a state's anti-terrorist financial regulation would have more legitimacy internationally even than the FATF's. Though the FSAP is currently only a voluntary program – states must invite the IMF's investigation – there has been talk of changing this policy, and there is no reason that even in the short term particular types of IMF assistance, or bilateral aid, might not be conditioned on successful anti-terrorism FSAP report.

The principal objections to such an expansion of the FSAP would come from the IMF itself, and are not without merit. The IMF views itself as fundamentally unbiased and impartial, a “technical” agency, and would shrink from initiatives which threaten to embroil it in political

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<sup>102</sup> IMF, “Offshore Financial Centers,” [www.imf.org/external/np/ofca/ofca.asp](http://www.imf.org/external/np/ofca/ofca.asp) (Washington, D.C.: IMF, 2002).

<sup>103</sup> “Members took note of the important work underway by national authorities, the Financial Action Task Force (FATF), the IMF and World Bank and standard-setting bodies, which should

disputes outside its home turf of macroeconomics. The FSAP itself, while primarily a microeconomic evaluation program, is justified on the basis that stable and well regulated financial institutions are necessary for macroeconomic success.<sup>104</sup> Compliance with anti-money laundering standards, while doubtless politically worthy, is hard to justify as a core requirement for economy-wide stability. The IMF would also be understandably concerned if it appeared that the FSAP were being used to openly advance the political goals of one country against others – the US versus the developing countries or the Arab world.

The IMF, however, is singularly positioned to fulfill the needs of the international community with regard to the monitoring of anti-terrorism financial regulation. Integrating the FATF's Special Recommendations into the FSAP would create institutional stress within the IMF, and moving FSAP participation from voluntary to mandatory status would mobilize international resistance. For the United States, however, the gains in terms of international harmonization and enforcement of norms would be worth the struggle.

### **US Procedures for International Information Exchange**

The United States maintains a degree of control over foreign financial information simply by virtue of its role in the international financial system and its control over particular private financial institutions. Under the doctrine of global, consolidated supervision, American bank regulators will insist on US banks' foreign operations remaining subject to US oversight, and

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strengthen the fight against terrorism financing.” Financial Stability Forum, press release, <http://www.fsforum.org/Press/P20020326.html>, March 26, 2002.

<sup>104</sup> “Resilient, well-regulated financial systems are essential for macroeconomic and financial stability in a world of increased capital flows.” IMF, “Financial Sector Assessment Program,” [www.imf.org/external/np/fsap/fsap.asp](http://www.imf.org/external/np/fsap/fsap.asp) (Washington, D.C.: IMF, 2002).

hence available for anti-terrorism surveillance. In addition, American regulators may require any foreign bank maintaining a correspondent account in the US to provide details relating to the beneficial owners of the account, even if this information is not located within the US. Failure to provide this information within ten days may result in the foreign bank being prohibited from holding correspondent accounts in the United States.<sup>105</sup> While this threat is certainly substantial enough to ensure compliance in almost all cases, it does not allow investigators to reach all of the financial data that would be needed for complete tracking of terrorist assets from the US back to their origin. For these purposes, interaction with a foreign jurisdiction is necessary.

Investigating authorities in the United States have three formal avenues through which to obtain financial information from abroad. They may issue subpoenas, submit letters rogatory to foreign courts, or rely on the provisions of Mutual Legal Assistance Treaties (MLATs). This section will briefly examine the implications of each.

Subpoena power is the most limited of these three methods. Subpoenas may generally be served on US nationals or permanent residents, and on the US branches of institutions whose foreign branches possess the desired information.<sup>106</sup> Certain statutory provisions also grant explicit extraterritorial jurisdiction for certain activities, as has been seen in the examination of the money laundering statutes, and will serve as authorization for a foreign subpoena. Such extraterritorial subpoenas, however, are generally disfavored both by foreign courts and by the Department of Justice, and are viewed only as a last resort when no alternative mechanism seems available.<sup>107</sup> In addition to technical problems of enforcing US subpoenas in foreign jurisdictions, such methods

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<sup>105</sup> 31 USC §5318(k).

<sup>106</sup> See U.S. Dept. of Justice, *United States Attorneys' Manual* "Sec. Sec. 9-13.525 (October 1, 1988).

<sup>107</sup> See Andeep Savla, *Money Laundering and Financial Intermediaries* (Boston: Kluwer Law International, 2001) 174.

tend to be quite slow and very public. At best, extraterritorial subpoenas seem appropriate for prosecutions requiring foreign evidence, but they provide little assistance for covert financial intelligence gathering or routine surveillance.

Letters rogatory have traditionally been the alternative to MLATs. Letters rogatory, such as those authorized in Rule 28 of the Rules of Federal Civil Procedure, essentially request a foreign judicial authority to assist in obtaining evidence within foreign jurisdiction.<sup>108</sup> Such letters are executed solely as a matter of comity, not obligation, and may not provide for the taking of evidence in a way that will be admissible in a US court proceeding. Letters rogatory have also been found to be extremely cumbersome in operation, and too frequently frustrated by domestic bank secrecy legislation.<sup>109</sup>

The preferred means of formally obtaining financial information from foreign financial institutions has therefore been through treaty. The first American MLAT, involving Switzerland, was ratified in 1976; since then the US has become a party to more than twenty such agreements currently in force, and a number of others have been signed and are awaiting ratification.<sup>110</sup> MLATs essentially impose a bilateral obligation on the signatories to assist one another in criminal investigations and proceedings. Typically, this assistance is defined broadly enough to encompass the entire range of investigative activities, including pre-charge surveillance. Some, but not all, MLATs also apply to civil and administrative proceedings. Many MLATs exempt

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<sup>108</sup> F. Rules. Civ. P. 28(b).

<sup>109</sup> See US Senate, "Report of the Senate Committee on Foreign Relations, with respect to the Treaty with the Philippines on Mutual Legal Assistance in Criminal Matters," July 30, 1996, citing Mark M. Richard [Deputy Assistant Attorney General, Criminal Division], "Worldwide Review of Status of U.S. Extradition Treaties and Mutual Legal Assistance Treaties," statement for hearings before the House Committee on Foreign Affairs, 100th Cong., 1st Sess. 36-37 (1987).

<sup>110</sup> See Frances Townsend, Acting Deputy Assistant Attorney General, remarks before the National Institute of Justice, [www.ncjrs.org/mlats.htm](http://www.ncjrs.org/mlats.htm), February 1998.



from coverage certain tax-related crimes, but in general ‘dual criminality’ (the concept that the offense be a crime in both jurisdictions) is not a requirement.<sup>111</sup>

The practical operation of a MLATs is designed to be less formalistic than either subpoenas or letters rogatory. MLATs customarily designate Competent Authorities for each party, through whom requests for information are transmitted. This centralization is one of the key benefits of the MLAT – the efficiency and rapidity of the information transfer is a great improvement over the laborious circulation of letters rogatory.<sup>112</sup>

MLATs typically provide for assistance in obtaining evidence which may include (1) the taking of testimony or statements of persons located there, (2) service of documents, (3) execution of requests for searches and seizures, (4) the provision of documents and other articles of evidence, (5) locating and identifying persons, and (6) the transfer of individuals in order to obtain testimony or for other purposes. MLATs have also increasingly called for assistance in immobilizing assets, obtaining forfeiture, giving restitution, and collecting fines.<sup>113</sup>

The advantage of the MLAT for a US financial investigator is clear: the treaty facilitates early-stage investigative cooperation, and makes it feasible for financial authorities to obtain information far more rapidly than would be possible with only common law tools. The statutory form of the treaty, and its enacting legislation, make enforcement of its terms far more predictable, and investigators may rely on their foreign counterparts’ assistance out of legal obligation rather than merely politeness.

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<sup>111</sup> See US Senate, “Report of the Senate Committee on Foreign Relations, with respect to the Treaty with the Philippines on Mutual Legal Assistance in Criminal Matters,” July 30, 1996.

<sup>112</sup> This procedure is similar to that employed in Bilateral Tax Treaties – though the network of MLATs is not as well-developed as that of BTTs, and thus more heterogenous.

The drawbacks to the MLAT system are similar to those for any system of bilateral treaties. First, they are cumbersome and time-consuming to negotiate – the small number which now exist are wildly diverse both in their individual terms and in their geographic impact. Second, those jurisdictions where a MLAT would be of most benefit for the US have little to gain from negotiating one. It has been observed that tax havens have few bilateral tax treaties with high-tax jurisdictions, and those that do have rejected information-sharing provisions; the same pattern should be expected for MLATs. Third, while somewhat more rapid than subpoenas or letters rogatory, MLATs still operate in the realm of formal, rather stiff interactions between high governmental authorities. The target of a MLAT request is certain to be alerted to the US investigator's interest, and terrorists will not sit still for the machinery to grind slowly, no matter how fine.

As a response to this difficulty, a number of less formal approaches have been devised to encourage foreign participation with US investigative efforts. Informal requests directly between US regulators and their counterparts abroad can produce rapid and satisfactory results, as can information requests routed through Interpol or diplomatic channels. Some executive agreements have been reached which provide for information exchange in relation to specific topics (narcotics, for instance). At times, close cooperation can also be achieved by persuading a foreign regulator to launch a "joint" investigation of a particular institution or individual.<sup>114</sup>

The distinction between the informal and formal paths is easy to predict. Cooperation required by treaty or obtained through text-book legal channels is slow, tedious, and (for the investigator)

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<sup>113</sup> See US Senate, "Report of the Senate Committee on Foreign Relations, with respect to the Treaty with the Philippines on Mutual Legal Assistance in Criminal Matters," July 30, 1996.

disturbingly public. Information exchange carried out on the basis of informal understandings, precedent, custom, and shared interests works much more rapidly and, significantly for anti-terrorism surveillance, may be accomplished without alarming the target organizations. While the formal approach to financial evidence may be appropriate for the prosecution of terrorists in custody, it will be of much less value to regulators carrying out routine and covert surveillance.

Informal cooperation, however, is entirely predicated on political goodwill abroad, and this goodwill is therefore vital to the American effort to track terrorist assets. If the United States is forced to rely solely on the formal obligations of foreign states to obtain financial data from overseas, its ability to meaningfully control the flow of financial assets will be seriously compromised. Guidelines such as those suggested by the FATF may help give the US moral leverage over other countries, and IMF oversight of compliance with the Special Recommendations would mightily assist in assuring that programs are in place facilitate effective cooperation. None of those programs, however, will succeed in establishing formal requirements which will function as well as whole-hearted voluntary support.

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<sup>114</sup> See US Senate, "Report of the Senate Committee on Foreign Relations, with respect to the Treaty with the Philippines on Mutual Legal Assistance in Criminal Matters," July 30, 1996.

## CHAPTER 5: PROPOSALS AND REFORMS

The funds which make terrorism possible are not constrained by jurisdictional boundaries, and the effort to trace those funds must be equivalently international. Because nations maintain separate and distinct financial regulatory regimes, however, analysis of ‘next steps’ in the fight against terrorist financing necessarily breaks down into those measures which the United States can undertake on its own – legislation, regulation, and institutional reform – and those which require international cooperation, either formally or informally.

### *Domestic policies*

The strength of the American investigative authorities derives from the massive resources which have been devoted to anti-money laundering investigations, and the precision with which transactions can be traced by financial regulators, as well as the real cooperation of most actors in the formal financial market. The following discussion focuses on a number of ways in which that strength can be augmented, both by rationalizing the deployment of regulatory resources, and by increasing the thoroughness of the financial data available to anti-terrorism investigations.

#### *Eliminating Hawala*

The greatest technical impediment to domestic anti-money laundering efforts is the continued use of informal transaction mechanisms. US regulators can currently exercise effective surveillance over funds transferred through formal financial institutions, and their ability to control formal deposits has been greatly improved by recent regulation. The black market in pesos, the Asian system, and Hawala exchanges, however, negate all the benefits conveyed by this tight network of regulatory controls.

US surveillance of the financial system depends on all financial transactions occurring through formal, regulated financial institutions. Money transferred through alternative mechanisms never passes through screening mechanisms at the border and may elude anti-money laundering rules when it enters the formal system. Simply put, there is little reason to expend money and energy on anti-terrorist controls for banks if non-bank avenues for international transfers are easily available to the terrorists. No SAR system, no “special mechanisms,” and no correspondent account identification program will be of the slightest use so long as unregulated informal money transfer networks can evade the entire regulatory process.

Perhaps the most pressing goal for law enforcement and regulatory agencies at the current date is to eliminate the alternative transfer mechanisms. Hawala exchanges and all other unlicensed transaction systems should be the subject of massive enforcement programs, and violations of licensing, reporting, and record-keeping regulations should be prosecuted without compunction. While this may at times strike outside observers as unduly harsh – an individual Hawala dealer is certainly not a danger to society in the same way as a man with a machine gun – the entire Hawala system as a whole represents a massive threat. Because of the loosely-connected nature of the system, the only way to eliminate these transactions will be to prosecute the individual dealers to the full extent of the law.

This is essentially a law enforcement issue. Alternative transfer systems often developed from a mistrust of official financial systems, and have been continued through criminals’ desire to avoid regulatory scrutiny. It should be noted that some of the underlying causes for the development of alternative systems’ development in Latin America, South-East Asia, and India – inadequate banking networks, currency exchange controls, and high transaction costs – have begun to disappear, and legitimate financial traffic is moving overwhelmingly toward the formal financial institutions. This leaves criminals and terrorists alone in the alternative systems, and should make

those systems more vulnerable to investigators: money currently in the system is much more likely to be related to drugs, fraud or terrorism than to remittance income from immigrants to their families.

Locating, infiltrating, and destroying these networks will require significant commitments of manpower and intelligence resources. There is, however, no real alternative, and the cost-benefit analysis is heavily on the side of action. For the financial war on terror to succeed, the first requirement is that all financial transactions occur in the regulated financial sector. Non-regulated international flows of funds undercut every other anti-terrorist regulatory effort.

#### *Reducing the use of cash*

The use of large quantities of cash also effectively removes a transaction from regulators' tracing systems; where a credit card payment or check could give valuable information, cash simply remains anonymous. Regulators recognizes the vulnerable status of cash at the moment when it is deposited in banks or moved across international borders, and hence the development of Customs declarations, SARs for large cash deposits, and the recent criminalization of bulk cash smuggling.<sup>115</sup> The use of large quantities of cash to avoid creating an audit trail, however, extends to transactions within the United States, and should be easily remedied.

First, the rules prohibiting bulk smuggling of cash across international borders should be extended to unlicensed movements of bulk cash within the territory of the United States.<sup>116</sup> Any movement of bulk cash with knowledge that the funds are intended to be used for unlawful

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<sup>115</sup> See 31 USC §§5313 and 5332.

<sup>116</sup> Currently set at \$10,000. 31 USC §5332.

purposes should constitute an offense, and the statute should provide for automatic confiscation of the funds.

Second, the use of cash to settle large transactions should be prohibited. In an era of cheap banking accounts, debit cards, ubiquitous ATMs, and omnipresent credit card readers, the use of cash for transactions running into the hundreds or thousands of dollars seems either anachronistic or suspicious. Regulations currently impose reporting requirements on all banks dealing in large cash transactions (over \$10,000) and the only reason this rule should not apply to other types of businesses is that such large cash transactions would be extremely rare. The only non-financial cash transactions on that scale are certain to be criminal (no one pays for a new car with \$20 bills) and those transactions would never be reported even if reporting for them were mandatory. All cash payments over a certain limit – perhaps \$1000 – should therefore be eliminated, and anti-smurfing provisions, similar to those for bank deposits, should ban the structuring of transactions so as to avoid the \$1000 limit. Any transaction over that limit should occur through the formal financial system, and should create an audit trail for later investigators.

Finally, the development of e-cash transfer systems raises questions that will have to be examined by regulators in the future. Electronic cash creates the possibility of long-distance financial transactions with many of the anonymity features of true cash – a combination of wire transfer efficiency with currency transfer secrecy. Any new financial technology will inevitably be misused by criminals and terrorists, and financial policy-makers should insure that the legislation designed to authorize legitimate innovation allows for adequate regulatory flexibility to respond to these challenges.

*Getting the administrative structure right*

The administrative structure for the anti-terrorism campaign matters for two reasons. First, much of the legislation and all of the regulation which will drive the financial investigations must arise from the executive branch; Congress simply lacks the technical capacity to develop meaningful initiatives on its own. Second, implementation of the regulations is critical, and the cross-disciplinary, cross-border nature of anti-terrorism financial surveillance requires a particularly complex interaction between different types of governmental authorities. It is always difficult to offer useful suggestions about organizational structure from the outside – and even more so in the field of anti-terrorism, where many of the organizations are purposefully secretive – but a number of general points can be made.

Officials at the highest levels of government should attempt to facilitate organizational change, rather than resist it. Every major conflict of the twentieth century – both World Wars, the Cold War, Korea, Vietnam – has created new challenges for the bureaucracies, and in each case there has been a period of turf-fights as the organizations morph into forms that better respond to the new situations. It is not expected that bureaucratic reorganization will occur spontaneously or rapidly, but leaders should recognize that some type of flexibility is required if the United States is to adequately prepare itself for the anti-terrorism campaign. The Secret Service, for instance, a Treasury office, has responsibility for both Presidential protective duties (something more appropriate for the Justice Department) and for counterfeiting investigations (a task perhaps better assigned to the Financial Crimes Section of the FBI, or one of the criminal investigative units of the Treasury). The fact that this combination of responsibilities has long historical roots is not a justification, and the present feeling of crisis might be productively exploited for some overdue organizational house-cleaning.



Next, it is important that policy decisions incorporate the broadest range of experience and input. Effective control of terrorist assets is not purely a law enforcement matter, nor is it solely within the purview of financial regulators or international relations experts. There currently seem to exist a number of inter-agency and inter-departmental task forces, but all seem to be focuses on the exchange of information at an operational level rather than on a strategic basis. Legislation submitted to Congress and regulations promulgated by the various agencies should reflect the combined judgment of across the executive branch at the highest levels. Collaboration between Departments and offices should be formalized at the policy-making level. There should be regular, institutionalized contact between officials dealing with anti-terrorism strategy – not just tactics – from each of the major agencies. The newly created office of Homeland Security may serve as a convenient venue for this type of interaction, though any agency could take the lead so long as others were willing to cooperate.

Finally, the inter-agency task force system should be formalized. There have been periodic suggestions in the past that all regulation aimed at illicit transactions – bank monitoring, export controls, money laundering rules, asset freezes – should be placed under a single administrative body. This is probably infeasible: regulatory agencies are designed to monitor systems, not to respond to particular problems. Nevertheless, government officials should realize that the financial anti-terrorism effort will be long-term, and that durable institutions must be established to support the war on terror. Inter-agency task forces and working groups for the exchange of information and coordination of policy are good, quick, temporary responses to the problem, but are not a substitute for formal offices with permanent staff, regular appropriations, and independent competence.

### **International cooperation**

The campaign against terrorism is fundamentally an international struggle, and the United States is severely limited in what it can achieve alone. This section will discuss the formal and informal advancements that would improve the reach and power of anti-terrorism financial investigation.

#### *Implementing the FATF Special Recommendations*

The FATF has proved itself a successful organ for the establishment of international anti-money laundering standards, and the anti-terrorism theme is so closely related that continuing to push for policy reform through the FATF makes excellent sense. In order for the FATF's anti-terrorism work to become truly useful, several initiatives should be made a priority.

First, the voluntary compliance program which reviews FATF members' own regulatory regimes should be expanded, as planned, to embrace anti-terrorist financing measures. The periodic reports currently issued by the FATF have proven themselves useful for distinguishing strategic deficiencies in states' regulatory networks, and this procedure should be useful for anti-terrorism work as well, both to alert regulators to potential weaknesses and to spur legislators to action.

Second, the FATF list of NCCTs should be supplemented by a 'list of anti-terrorism NCCTs', and the criteria for that designation should be tailored as close as possible to the criteria used by the Treasury for "special measures" determinations under 31 USC §5318A. The US will benefit twice by outsourcing as much of the systemic analysis of jurisdictions to the FATF. Though the US in fact contributes heavily to FATF resources (budgetary and staffing), work done by the FATF still reduces the Treasury staff's immediate workload. More importantly, "special measures" are a form of unilateral sanction, and the US will gain by having an international, objective imprimatur for those measures. Other FATF states will probably also maintain "special

measures” lists of jurisdictions meriting particular regulatory attention, similar to those established in the US, and guidelines for anti-terrorism NCCTs should allow as many countries as possible to piggy-back on the FATF’s analysis.

Third, the US should work to give teeth to the NCCT designation beyond its own, unilateral policy. Establishing a common FATF sanctions policy against NCCTs should be a major goal of current negotiations. Terrorists’ money need not arrive in the United States directly from a suspect country: it is just as dangerous if it arrives in the US indirectly via one of the foreign banks based in jurisdictions with slightly less stringent anti-terrorist financing provisions. As the funds transferred prior to September 11<sup>th</sup> to Osama bin Laden’s accomplices from German accounts demonstrates, even well regulated and thoroughly supervised banking systems may be vulnerable to terrorist infiltration. All the members of the FATF would be well served by a common external policy toward jurisdictions known to be uncooperative in the anti-terrorism effort.

Finally, the US should work with other FATF members to internationalize the Special Recommendations. The IMF is the logical venue for this process, through collaboration with the FSAP. The IMF currently rates countries’ financial systems according to the quality of their corporate governance, based on OECD guidelines, and there is no reason that it should not rate them on the basis of anti-terrorism standards, based on FATF recommendations. Various parties both within and outside the IMF will object to such an approach. FSAP evaluations, however, would serve to inject a needed element of objectivity into international discussions of how to control the financing of terrorism, and honesty is a small price to pay for security.

*Strengthening international information exchange*

The tracing of terrorist financing is more an intelligence exercise than a legal procedure: the US gains far more from knowing who the money came from, who it went to, and how it got there, than it does by actually seizing the funds themselves. This fact must be kept in mind when evaluating US interaction with foreign regulatory and law enforcement authorities. Receiving information itself is more important than receiving the information in a legally cognizable form.

Unfortunately, the formal methods of financial information exchange are primarily intended to produce information which could serve as evidence in a court of law: depositions, notarized bank records, testimony under subpoena. These are not the forms of inquiry which will lead to rapid, quiet, and seamless flows of financial data between jurisdictions and across international frontiers.

The most profitable approach for the US regulators vis a vis their foreign counterparts is undoubtedly to foster close, informal and routine information sharing programs that rely on mutual interests rather than on legal obligation. MLATs are useful in certain circumstances, but in conditions of ‘diplomatic scarcity’, US efforts should be put into negotiating a strong NCCT listing program: the former provides mandatory (even if grudging) cooperation between the US and only one other country, whereas the latter offers the possibility of good-faith assistance from a large number of jurisdictions.

The Egmont Group, the FATF, Interpol, and the Basle Committee should all play a role in fostering such informal information exchange. Investigations should be routinely pursued jointly by several FIUs if that seems to avoid technical barriers to cooperation. Prudential regulators may be formally put in charge of particular surveillance operations if information exchange between

bank regulatory agencies seems to work best in some situations. The emphasis in each case should be on pragmatic structures which allow the broadest access to vital financial data. If criminal prosecution is an option at a later date, then probably the terrorists involved will already be in custody and the funds may be investigated, officially, at leisure. The priority for the moment, however, is to simply follow the money.

### **Conclusion**

Terrorism cannot be conquered by financial analysis. The amounts of money involved in making bombs, buying airline tickets, and funding death are simply too small, the international markets are too vast, and too much of America's own economic security depends on the unimpeded global movement of funds. The seizure of some terrorist assets can uproot particular organizations, and disrupt particular operations, but there will continue to be some individuals or some states which continue to provide resources.

The movement of those resources, however, can be analyzed, and that analysis has tremendous value to the entire US campaign – and the campaign of many other nations – to eliminate terrorism. Providers of funds can be located, arrested, or killed; states that support terrorism can be embargoed or attacked; organizations which enable terrorist attacks can be dissolved. In each of these cases, the key is knowledge: governmental authorities must know where the money came from, where it went, and how it got there. Seizure of illicit funds is good, and prosecution of the guilty is better, but understanding the financial transactions involved remains the most important aspect of these investigations.

This paper has demonstrated that inside the territory of the United States, existing laws provide adequate means for investigators and regulators to trace terrorist funds if they are within the

system of formal financial institutions. Efforts to move all finance within the formal system should therefore be the next priority, alongside organizational restructuring to insure that the legal capacity of the multitudinous US agencies is employed effectively.

Asset tracing within the United States, however, is almost useless without international cooperation, and that cooperation is, as with most things international, largely a product of politics. The US can assist in creating formal international structures, such as the FATF Special Recommendations, which encourage and harmonize cooperation against terrorism, and it can lobby for objective monitoring of that cooperation by international agencies such as the IMF. Ultimately, however, American success on the international scene will depend, for financial investigations as for all other aspects of the war on terror, on the voluntary cooperation of other nations, and their willing assistance.

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