

Banks, money laundering and terrorism

published in Euromoney

Money laundering practice is in confusion as banks struggle to understand terrorist financing and government fails to support the financial community with resources skills and systems. That is the conclusion of two years of frantic activity and expenditure by the world's banking system, post September 11. The implications for global security are obvious and alarming.

The importance of the banks' role in the fight against terrorism could not have been spelt out more clearly by George W Bush himself, shortly after September 11 2001. "We're putting banks and financial institutions around the world on notice, we will work with their governments and ask them to freeze or block the terrorist ability to access funds." The message was clear: banks were in the front line as government agents against terrorist money laundering. Two years later, a balance sheet of the financial community's success against terror can be drawn up. The results are not looking very satisfactory.

There are two explanations. Either the terrorist money was never in the system, or the money was in the system, but the controls were not adequate to spot and seize it. Strong evidence published after the September 11 outrage suggested al-Qaeda used couriers to move cash rather than banks to carry wire transfers. The International Policy Institute for Counter-Terrorism (ICT) reported: "All too often al-Qaeda operations bypass the more traditional money laundering techniques - such as the use of electronic transfers and offshore accounts - that might provide clues to sources and methods. In many cases, there is no 'paper trail' to follow; cash is simply slipped into a suitcase and carried by a courier to its recipients." [\(1\)](#)

Terrorists have understood the anti-money laundering systems enough to avoid them, but has the financial system understood terrorists enough to catch their money. September 11 undoubtedly provoked a massive clampdown on loose practices with strengthened controls on customers, and identity checks imposed routinely for new customers. Banks and financial institutions spent heavily hiring large numbers of anti-money laundering (AML) staff. Lowly-paid officials from state law enforcement organisations moved in droves into banks' AML systems. Qualified anti-money laundering officers were scarce and commanded a premium. One of these, Rick Small, a former investigator at the Federal Reserve, was hired to Citibank for a reputed seven figure salary. They were quickly forced to study the complex and massive USA Patriot Act published in October 2001, which rewrote many of the conditions under which US banks could deal with non-US institutions dealing in dollars and operating in the US. For all the expense and new law, money laundering systems and staff struggled to adapt anti-money laundering mechanisms to the peculiarities of terrorist financing. The two sources of money are very different. Whereas organised crime uses the system to wash large sums of cash obtained from drugs deals, prostitution, below-the-counter business of all kinds, terrorist money is much murkier. These underground operators have neither large amounts of dirty cash to deposit, nor do they want to clean it. Terrorist money bypasses the

'layering' stage in the criminal money laundering process because its transfer is determined by the immediate purpose for which it is required, namely funding an outrage not hiding or making money for its own sake. The low levels of terrorist cash requirements are paradoxically one reason why banking systems fail to pick them up. Systems designed to catch financial criminals are largely geared to the scale of the bank's own financial risk from the black money, so the larger the suspicious amount, the louder the signal will ring that something is wrong. Terrorists live cheaply and their material costs are low so even if the bank does spot something amiss, it is likely to trigger only a low level investigation unless the external warning signs are very strong. September 11 terrorists funded their operations, which reputedly may have cost no more than \$500,000, with a mixture of cash and wire transfers from a bank account in the United Arab Emirates. These were banal transactions that interested nobody. A UAE money exchange house transferred funds to its correspondent account at a New York bank. A credit was sent to the Florida bank. It was then credited to the hijackers who had accounts at the bank. Says Casella, 'On the surface, these transactions were completely innocuous. The funds come from an unknown source, which may have been the personal fortune of a wealthy businessman or it may have been money raised for humanitarian purposes. The source of the money doesn't matter, what matters is the deadly purpose the money was intended to fund! The terrorists stood in line and wire-transferred the remaining unspent funds that they had been using to finance their operation, back to the United Arab Emirates so that they could be re-cycled and used by the next group to perpetrate the next terrorist act. Large cash deposits and bogus purchases of houses or valuable products ring alarm bells. But unknown charities, wealthy donors or apparently reputable corporations, the likely sources of terrorist funds, do not ring such alarms. Arguing that these sources handle dirty cash or fund terror takes a bold bank and police force with deep investigative skills. Government cannot be satisfied until banks are capable of examining sources of funds for their criminal potential, says Department of Justice official, Stephan Cassela. He demands that banks revise their procedures to accommodate the terrorist threat. Casella argues that funds need to be analysed for the crime they are about to finance in the future, rather than the crime with which they may have been associated in the past. This variation on the AML theme is called reverse laundering. 'Reverse money laundering examines the conduct of financial transactions that look towards the commission of a future crime. It is very simple and narrow, like the statute that says it is a crime to conduct a financial transaction to conceal or disguise the proceeds of drug trafficking. Statutes need to make it an offence to conduct a transaction intended to disguise the provenance of any crime that is foreign or domestic.' Casella attacks current money laundering standards. 'We have been looking backwards at what happened in the past and how that has been hidden. Now we need to look forward to what the criminal may intend to do with these same dollars as he launders them in the same way. Criminals can use clean money or money from an unknown source to commit some crime in the future. Casella attacks American legislation on money laundering which he says is 'mostly backward-looking and not forward looking'. The terroristic type financial manipulation 'does not violate existing laws. In the US we have only just begun to address this problem through legislation.' Adam Bates, a partner at KPMG specialising in forensic issues, also dismisses the ability of anti-money laundering controls as presently implemented to track terrorist finance. ' Money-laundering systems generally can't trace [terrorist money]. Changing

money laundering controls won't help to catch the sleepers because they do not have any suspicious traits, they don't have big cash deposits or make any transfers to Liechtenstein. 'The systems won't pick up the 'sleeper' who comes to live in the country. The IRA would give them £5000 to live off for a year. They would send it from accounts in Ireland. You have to wonder who is going to question someone who says, my father wired me the money. The money pays for his out-goings. Students have that sort of money from their parents and it is no different. Depending on how good the terrorist is, he will model his behavior to seem like the perfect model citizen.' The same problems have haunted the pursuit of the September 11 terrorists. Bates: 'When September 11 occurred the various agencies issued lists of names to the banks. This was like reverse engineering. They looked through their accounts and if they saw anything suspicious, they were told to tell the police. That is a bit odd because a lot of these accounts will not look suspicious. The terrorists who did the stuff in the US lived pretty normal lives when they lived in the US. They weren't very odd people who spent lots of money.'

'Some terrorist money comes from straight money laundering and some of their money comes from reverse money laundering. Reverse money laundering is turning clean money into dirty money to use it as an instrumentality for terrorism. You need exactly the same systems that you'd use for money laundering. To protect a charity, you need to be able to create false invoices and to push money offshore.'

Reverse laundering looks fine in theory, but implementation poses problems. AML systems are based on computer-based measures of probability and risk, linked to unusual transactions or activity. Reverse laundering, on the other hand, requires much closer analysis of sources and destinations of funds. It also requires banks and government to keep and update libraries of names of fraudsters, criminals and terrorists. Closer co-operation between the public and private sectors will be required, with civil liberty objections to snooping into bank accounts foremost in the public's minds. Banks must not merely be the watchdogs for dirty money coming through cashiers, they must also be sleuths capable of quickly unearthing tell-tale signs of criminal potential. Networks linked to criminal activity and a familiarity with places of criminal operation are now parts of the banking armoury. Exclusion of 'politically exposed persons' has now become established banking practice as this new regime takes shape. Reverse laundering adds a string to the bow of the anti-money laundering programme, but it does not replace it, says Casella. Terrorists are capable of using the same money laundering techniques as criminal financiers, he says. These include 'convoluted transactions to hide the location of the money, or its destination'. They also use the same clandestine shipments of cash to avoid paper trails and use international shell companies to move funds between accounts and between countries to make money destined to be used in a crime appear legitimate. 'It is as important to harness the tools of money laundering enforcement, like bank regulation, know-your-customer policies, prosecution and asset confiscation to interrupt these schemes that have yet to reach fruition as it is to recover the proceeds of crimes that have already been committed in the past.' Financial sophistication displayed by terrorist groups demonstrates their links to organised crime, argues an FBI agent, 'we strongly suspect that illegal networks of organised crime support small, but deadly, groups of terrorists, who, like organised criminals, have a

need to move people and especially money from country to country whilst escaping the scrutiny of law enforcement agencies.' Patrick Moulette, the head of the Financial Action Task Force, the international body setting guidelines for national polices against money laundering, shares this view. ' Terrorist groups are themselves involved in organized crime, money-laundering activities. One of the difficulties for the FATF is when the money comes from a legal origin, in the case of charity foundations and other entities. We are working on the eighth recommendation, which deals with non-profit organizations.' The FATF issued eight guidelines dealing with terror finance in the wake of September 11, to add to its authoritative list of 40 guidelines then in force. The organisation is currently examining procedures for wire transfers to ensure banks have greater information about the beneficiary of the transfer and that as much information as possible is supplied throughout the payment chain. Jack Blum, the authoritative Washington-based lawyer, who helped bring the BCCI scandal to the attention of the New York authorities, links Islamic terrorism specifically to the drugs industry. 'Money laundering and terrorism is all one ball of wax. The terrorist marries into the lawlessness. People don't notice the connection if it suits their purposes. I am sick of people saying the money's a trivial amount and the odds of anybody picking it up are zero. That's not the issue. The gross national product for Afghanistan for ten years was heroin, period. Heroin money built the Madrasses and bankrolled Mullah Omah. A combination of heroin money and Saudi money brought us this terror.' Terrorists use of the cash economy has led to a beefing up of laws on cash movement and handling. So 'bulk cash smuggling' or 'currency smuggling' (that is moving cash abroad without notifying US Customs) has been made a much more serious offence. According to one consultant, 'the free transport of currency in any amount in or out of the US is still entirely legal. All the traveller has to do is to report if he is transporting more than \$10,000 in or out of the country. This report is logged by US Customs.' Failure to make this report equates to smuggling and is punished accordingly. The smuggled money can also be confiscated in the same way as jewels or counterfeit CD recordings are confiscated. The new Act also makes it a crime to 'transmit, transport or transfer any amount of money, from any source, into or out of the US if the purpose of the transmission or transfer is to promote some criminal act.' This pulls in schemes quite unrelated to money laundering. So if a fraudster attracts funds through making a false promise - the advance fee fraud- and sends the money abroad, he is committing 'reverse laundering'. If found, the money could be seized even though it was honest money, because it was aiding a future crime. The courier caught transmitting large quantities of currency in his car or hidden on his person is caught under the reverse money laundering principle if he knows that the money will be used by a criminal at its destination. Funds sent by wire, as a cash deposit, a monetary instrument, or in the form of a real estate transactions are equally suspect. Money remitters are pulled into US law for the first time with the Patriot Act. Transmitters are defined as 'people who either formally or informally engage in the transfer of money from one place to another for third parties.' The money remitter who knows that money he send will be used for a crime, is treated as a reverse launderer. The scale of money remitting both in the US and abroad is such that licensing and regulation have proved extremely controversial. Indeed, it is understood the US and UK authorities are currently at loggerheads with European governments over the feasibility of regulating money remitters. At one end of the remitting spectrum are Western Union, in the middle are bureaux de change who have shop fronts. At the other end is the myriad of

Hawala agents. Hawala agents, who have no public face, fall outside any controls. The [Hawala](#) money transmission service uses agents - called hawaladars - to receive and pay money within their local community on the strength of faxed requests from agents known to them in other countries. Accounts are regularly balanced by the agents, without money or goods having to leave the country. The system flourishes particularly in the Gulf where it is used by honest parties - in particular expatriate workers-- to make remittances to their families in the Indian Sub-Continent. Counterparties transferring funds out of the Sub-continent are largely Indian and Pakistani evaders of local currency controls. The scale of Hawala is huge. For example, of the estimated \$5-6bn sent to Pakistan from Gulf states every year, only \$1bn goes through normal banking channels. The remainder is thought to be transferred through the Hawala system. The role of Dubai has long troubled US law enforcers, who have stated publicly that they believe it is a centre of terrorist financing. They say that Dubai's massive money transmitting agencies are loosely regulated, exposing them to abuse by Russians engaged in capital flight and by Islamic and other terrorist groups. America 's assault on Hawala in the wake of September 11 was focused on two Hawala money transmission schemes, called Barakat and al-Taqwa. These schemes acted as money transmission services between the US and Islamic parts of Africa, and were both closed. Paul O'Neill, Secretary to the Treasury, declared their closure a great victory on "the quartermasters of terror" [\(2\)](#) It is not known how much, if any terrorist money was seized, or frozen when US marshals moved in to Barakat, but the damage it did to the Somali financial system was quickly evident. Barakat was Somalia's primary money transmission mechanism, and when it was closed down, part of the Somali economy ground to a halt. One resident working for Seattle Public Schools explained "there's no other way any more to send money home to our families." Another with 15 dependent relatives in Somalia worried that "if we can't send them our money, I'm definitely sure they will die." [\(3\)](#) Five months after Barakat was closed down, the United Nations Development Programme (UNDP) launched a programme to formalise and legalise Barakat by bringing its workings into line with international law in order to avoid an even greater humanitarian crisis than already existed. [\(4\)](#) At the same time, US authorities admitted their suspicions about Barakat's role in funding al-Kaida was ill-founded. The failure of global financial institutions to produce a coherent front against terrorist money laundering suggests either the problem does not exist. Or else that the approach adopted by banks and law enforcement is missing the mark. Banks have clearly had their problems dealing with the aftermath of September 11. But so too has law enforcement. Suspicious Transaction Reports sent by banks to national Financial Intelligence Units for criminal investigation have mushroomed. But police investigators have failed to harness resources or skills to pursue them. This failure was highlighted recently when the UK's Financial Services Authority claimed the National Criminal Intelligence Service was awash with reports that were not investigated. ' NCIS is being swamped,' says Carol Sergeant, managing director for regulatory processes at the risk directorate of the Financial Services Authority. 'We don't know what exactly is happening to the reports. They just take this information and analysis and shove it out at the other end. No-one knows what happens to it when it goes out to the law enforcement agencies.' The crisis of confidence in the UK's anti-money laundering system forced the Government to spend £450,000 on an investigation of the system by KPMG. Sources in the Home Office, which sponsors the report, admitted the system 'could work better'. NCIS's problems flow from a burgeoning of

suspicious transaction reports over the last three years. The number jumped from 18,000 in 2000 to 30,000 in the following year, to 50,000 reports in 2002. The organisation, which is largely composed of policemen seconded from local forces, buckled under this strain. Regulatory pressures on banks were recently weakened by an FSA relaxation of guidelines for banks money laundering monitoring systems. Mixed messages from Government and poor co-ordination with the banking system has led to confusion in the financial and law enforcement community about the purpose of anti-money laundering measures. Claims that anti-money laundering systems are little more than tax raising tools now gain credibility, says Rowan Bosworth-Davies, a consultant with Control Risks. Bosworth-Davies sees a political motivation in the the recent money laundering campaign. 'The primary focus of Patriot legislation is not about internal banks it's about dubious foreign banks. It's all aimed outside, at nasty foreigners. Small nations are being railroaded into implementing laws and legislation which are being passed without necessarily a huge degree of thought. They're frightened of being further marginalised. Tax avoiders are a very potent target for a democratic governments. You've suddenly got these massive debates about how can we recover more tax? How much more power can we give to our tax authorities?' Tom Naylor, the provocative Canadian academic, see the hand of law enforcement in the push for tougher anti-money laundering activity, and he says that AML will be no more effective against terror than it was against drugs or fraud. 'Money laundering claimed to work pre-emptively. Its proponents argued that you stopped the terrorism from occurring by grabbing the money! But that's the same logic they used for fighting crime. It didn't work with crime and it's not going to work with terrorism. They have retroactively reconstructed a trail! Its not proactive, it is all purely retroactive. It is great to have the trail of evidence, which you will always want. But you didn't need any of this legislation to get this evidence! 'They go all over the world looking for Osama Bin Laden's billions! They don't exist boys! What he had was stolen from him by the Sudanese. Whatever little he had was frozen in Saudi Arabia or stolen by the new military government in the Sudan. When he arrived in Afghanistan he promised to build some public works in Kandahar and he ended up not being able to carry out his promises because he didn't have any money!'

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