

Banking without borders

Assessing money laundering and illicit financing challenges

Money laundering and terrorism financing are global problems that transcend national boundaries, and launderers and terrorists are constantly adapting their techniques to exploit vulnerabilities in the financial system to disguise the movement of funds. **Avi Jorisch** investigates.

KEY POINTS

- Criminals and terrorists conduct billions of dollars in transactions each year through the formal financial sector, the informal financial sector, the trade system and cash smuggling.
- Despite international attempts to develop a blueprint for fighting money laundering and terrorism financing, several countries and jurisdictions – particularly in the Middle East – have refused to implement anti-money laundering benchmarks and consequently lack the basic controls necessary to ensure that the international financial sector is not exploited by criminals, terrorists and their support networks.
- The US government and its international partners continue to blacklist countries that either fail to comply with international standards or refuse to have their financial systems evaluated.

In the past three months, two London-based banks – HSBC and Standard Chartered – have been accused by the US government of serving as a gateway for Iran into the international financial market. Both financial institutions have come under scrutiny from United States (US) regulators, who have made it clear that banks doing business in the US must cut their ties with illicit Iranian entities or risk losing access to the US market.

On 17 July 2012, the US Senate Permanent Subcommittee on Investigations issued a 335-page report (in addition to several hundred pages of supporting evidence, including bank records and internal emails) accusing HSBC of exposing the US financial system to a range of money laundering, drug trafficking and terrorist financing risks due to its poor anti-money-laundering (AML) controls. According to

the report, which was released following a year-long investigation into the bank, HSBC reportedly laundered money on behalf of Mexican drug cartels; acted as a major conduit to rogue regimes, initiating over 25,000 transactions on behalf of Iran in amounts totaling USD19.4 billion through its American affiliate, HSBC Bank USA, NA (known as HBUS) alone; provided correspondent banking services to suspect banks, including Saudi Arabia's Rajhi Bank (whose key founder was a generous Al-Qaeda donor) and other suspect clients; and offered services to bearer share corporations, used by money launderers to move funds, despite repeated warnings from regulators.

HSBC executives testified during a Senate hearing on the issue in July, at which the head of group compliance, David Bagley, announced that he would be stepping down amid the claims. The bank subsequently apologized for a "shameful" systems breakdown that failed to prevent money laundering activities and set aside USD700 million to pay for potential fines that may arise from the investigation, *The Guardian* reported on 30 July.

The following month, on 6 August, the New York State Department of Financial Services (DFS) accused Standard Chartered PLC of laundering over USD250 billion on Iran's behalf and facilitating over 60,000 transactions, *The New York Times* reported. According to a DFS order document, for almost 10 years, the bank operated as a "rogue institution" that served as a "front for prohibited dealings" with Iran. The Federal Bureau of Investigation (FBI) subsequently launched an investigation that reportedly uncovered money flowing to Iran, Libya, Myanmar and Sudan, in addition to a manual teaching employees how to mask illegal transactions. Standard Chartered issued a statement, published on its website, on 6

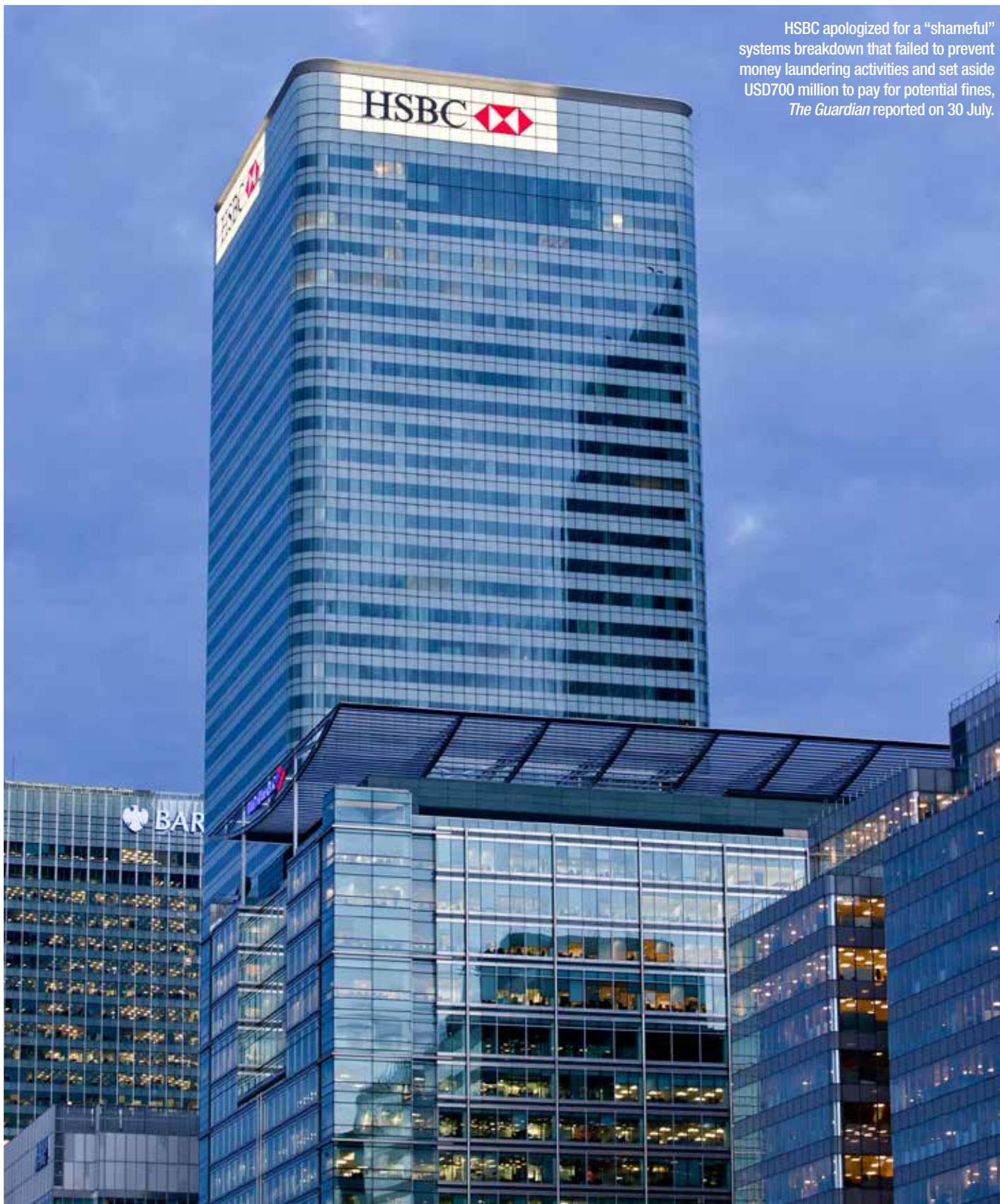
August that "strongly rejects the position and portrayal of facts" made by the DFS. Even so, on 14 August, the bank agreed to pay USD340 million to the DFS to settle the laundering claims, *The Guardian* reported.

As these investigations demonstrate, money laundering and terrorism financing are global problems that transcend borders. Those who engage in such activities are constantly adapting their techniques, while law enforcement and intelligence agencies attempt to keep pace. It is a complex challenge to combat, largely due to the diversity of methods used.

Launderers and terrorists both exploit vulnerabilities in the financial system to disguise the movement of funds. Money launderers make their money illegally and try to "clean" it to conceal its origins. Terrorist financiers, on the other hand, can make their money legally or illegally – their aim is to conceal both its origin and its ultimate intended use. In short, money launderers convert dirty money into clean money, while terror financiers take money and make it dirty by funding acts of violence.

The international community has over time realized and reacted to the enormity of the problem, calling for the establishment of comprehensive anti-money-laundering/combating the financing of terrorism (AML/CFT) regimes. Three objectives are central to these efforts: protecting the integrity of the international financial system; identifying, disrupting, and dismantling financial networks that underpin international criminal and terrorist organizations; and making it more difficult for criminals and terrorists to profit from their crimes.

It is an axiom within the US law enforcement and intelligence communities that the key to disrupting and dismantling criminal organizations is to "follow the money". The same is true with terrorist organizations. Following the



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Irene Dorner, president and chief executive officer of HSBC Bank USA, N.A. and HSBC North America Holdings, Inc., testifies before the permanent Subcommittee on Investigations hearing, “US Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History,” on 17 July 2012. The US government accused HSBC of exposing the US financial system to a range of money laundering, drug trafficking and terrorist financing risks due to its poor anti-money-laundering (AML) controls.

11 September 2001 attacks, officials in the US and abroad recognized that effectively fighting terrorist financing (and its corollary, money laundering) might be one of the most effective ways to prevent future catastrophic terrorist incidents. Unfortunately, many governments have had a difficult time converting this theoretical understanding into effective action.

As a new generation of public servants develop the skills necessary to contribute to the war on terrorism financing, the proven tactic of following the money will become more central than ever. At the same time, this task is also becoming increasingly complex due to the skill and ability of adversaries to avoid traditional financial counter-measures. Law enforcement and intelligence officials must learn to under-

stand the sometimes obscure methodologies employed by terrorist organizations to raise, transfer, and store money – whether these activities stem from Al-Qaeda, rogue regimes such as Iran and North Korea, or members of Hizbullah, Hamas or a host of other like-minded organizations.

A borderless problem

Time-tested means of moving money and disguising its origin are still effective, although each method has its vulnerabilities. Criminals and terrorists conduct billions of dollars in transactions each year through four principal means: the formal financial sector (banks); the informal financial sector (such as hawala – a simple broker system based on trust); the trade

system (commodities); and cash smuggling. Terrorists and their supporters have also perfected the exploitation of charities – including the Holy Land Foundation and Benevolence International Fund, both designated by the Treasury in the early-2000s as financiers of terrorism – which use all of these methods.

The International Monetary Fund (IMF) has estimated that money laundering accounts for 3-5 per cent of the world’s gross domestic product (GDP). According to the World Bank, global GDP was approximately USD72.3 trillion in 2007, which would place international money laundering somewhere between USD2.17 and USD3.61 trillion annually.

Given this scale and geographic scope, no country is immune to the challenge of stopping

the flow of illicit money. Money launderers and terrorism financiers have moved funds into all jurisdictions, including those with robust laws to counter such activity. Over the past 15 years, a few members of the international community have banded together to create a blueprint for fighting money laundering and terrorism financing. Unfortunately, several countries and jurisdictions – particularly in the Middle East – have refused to implement this blueprint. As a result, they lack basic controls necessary to ensure that the international financial sector is not exploited by criminals, terrorists and their support networks.

Just as the financial system has become global in nature, so too has the threat posed by tainted money. In confronting this threat, the system is only as strong as its weakest link – or as Daniel L Glaser, assistant secretary for terrorist financing at the US Department of the Treasury, noted in September 2005: “Laxity in just a few jurisdictions undermines the efforts made by the rest.”

Still, most countries in the Middle East have not taken even the most basic steps, such as criminalizing money laundering and terrorism financing, instituting controls in their formal and informal financial sectors, curbing cash smuggling, preventing abuse in the trade sector, and safeguarding the charitable sector. The inaction on the part of these countries continues to threaten the security of all nations.

Establishing an international framework

Governments serious about cracking down on illicit actors hiding the movement of their funds have taken the lead in creating international organizations with mandates to combat money laundering and terrorism financing. The most important of these organizations is the Financial Action Task Force (FATF), established by members of the G-7 (an international group consisting of the finance ministers from the US, UK, Canada, France, Germany, Italy and Japan) in 1989. FATF has since issued a set of standards on effective AML/CFT efforts and created a framework to assess compliance by individual countries. Although the organization has a limited membership of only 36 members, and lacks an enforcement capability, it has been surprisingly effective in curbing the ability of illicit actors to abuse the international financial sector.

FATF’s principal contribution is its frequently-updated International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation (or the 40 Recommendations). Typically referred to as “the international standard” for AML/CFT efforts, these recommendations were issued with the intention of universal application, to serve as a comprehensive framework against the movement of illicit money. These include the criminalization of money laundering and terrorism finance, implementation of proper controls in the financial sector to curb abuse and the blacklisting of rogue actors.

These standards center on three principles. First, countries must improve their national infrastructure to combat money laundering

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and terrorism financing. Second, each country is obliged to strengthen its financial system. Both banking and non-banking institutions must establish procedures to identify clients and detect suspicious transactions, as well as develop secure and modern transaction protocols. Third, countries must strive to improve international co-operation by collecting, analyzing and sharing AML/CFT-related information at the administrative and judicial levels. This includes sharing information on international currency flows and developing mutual judicial-assistance programs in order to investigate, freeze and confiscate illicit funds.

FATF’s official policy is to blacklist countries that either fail to comply with the international standard or refuse to have their financial system evaluated. This list is then published on the organization’s website, and FATF urges member states to send it to financial institutions and law enforcement agencies so they can take appropriate action.

Although the blacklist has no enforcement mechanism, it has nevertheless had an impact in changing the behavior of designated countries. For example, historically, once a country or jurisdiction has been blacklisted by FATF, financial institutions and other good corporate citizens have been reluctant to do business with, or in, these locations. Moreover, blacklisted countries that refuse to take remedial action have at times lost significant international investment as a result. In fact, the IMF and World Bank have sometimes chosen to downgrade a blacklisted country’s credit rating – a significant punishment given the interconnected nature of financial markets. This has forced many countries to remediate their policies and procedures and implement more robust controls.

Case study 1: Iran

As Iran continues to flout United Nations Security Council Resolutions (UNSCRs) putting pressure on its nuclear proliferation activities and sponsorship of terrorism, policymakers in Europe and the US have come to view sanctions as the last peaceful means by which to bring the Iranian government into compliance. Much of the controversy regarding its nuclear program has centered on Iran’s consistent failure to declare sensitive enrichment and reprocessing activities to the International Atomic Energy Agency (IAEA). Properly targeted sanctions may serve as a credible way of influencing the Iranian regime to change course.

Denied hard currency, Iran would find it far more difficult to continue pursuing nuclear weapons, supporting its surrogates around the world and inciting violence. Accordingly, both the UN and the US have taken steps to isolate Iranian banks suspected of funding such activities via the international financial system. Unfortunately, as the allegations against HSBC and Standard Chartered indicate, Iran still appears to have access to the financial sector through international banks that directly aid and abet it in obtaining foreign currencies, in direct disregard of the sanctions regime put in place by the international community.

Despite the sanctions and a concerted effort by many Western nations, several banks around the world continue to do business with Iranian financial institutions that are complicit in supporting terrorist groups and spreading nuclear weapons. On 4 January 2012, US Pres-



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The Governor of the Central Bank of Iran (CBI), Mahmud Bahmani, attends a press conference in Tehran, Iran, in August 2010. The US government signed into law sanctions against the CBI in early-2012 penalizing foreign financial institutions that do business with the bank, as well as allowing US institutions to freeze the property and interests of the bank.

ident Barack Obama signed into law sanctions against the Central Bank of Iran (CBI; or Bank Markazi), penalizing foreign financial institutions that do business with the bank, *The Wall Street Journal* reported. The following month on 6 February, the Obama administration also authorized legislation allowing US institutions to freeze the property and interests of the CBI, according to a White House press release. Nevertheless, the CBI still has access to the international financial sector, even though it has been accused of helping fund Iran’s nuclear weapons program, proliferating weapons of mass destruction and facilitating money transfers to terrorist organizations.

Beginning on 23 December 2006, with the adoption of UNSCR 1737 imposing sanctions on Iran, the UN ordered member states to cease all business dealings with a major Iranian institution – Bank Sepah – and its affiliates. It also urged governments to “exercise vigilance” in relation to two other Iranian financial institutions, Bank Mellī and Bank Saderat. All three financial institutions have been formally designated by the US government, prohibiting US banks from doing business with them.

On 8 September 2006, the US Department of the Treasury designated Bank Saderat, one of the largest Iranian-owned banks, for “facili-

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tating Iran’s transfer of hundreds of millions of dollars to Hizbullah and other terrorist organizations each year”. The Treasury alleged that from 2001 to 2006, Saderat transferred USD50 million to Hizbullah alone. In turn, the Lebanese Shia group used the bank to send millions of dollars to other terrorist organizations, including Hamas. In 2005, for example, Hamas had substantial assets deposited in Bank Saderat and Bank Saderat has transferred several million dollars to Hamas, according to a statement by the Treasury on 25 October 2007.

Bank Sepah, a state-owned Iranian financial institution, was designated by the US Treasury on 9 January 2007 for reportedly providing a number of financial services to companies involved in Iranian nuclear and ballistic missile activities. The UN and US government claim that the entities in question – the Shahid Hemmat Industries Group (SHIG) and the Shahid Bakeri Industries Group (SBIG) – are key players in Iran’s ballistic missile program. Sepah also provided services to the Aerospace Industries Organization (AIO), the parent company of these two entities. All three companies were designated by the US government on 29 June 2005 for their support to Iran’s missile program. According to the Treasury, Bank Sepah processed and arranged financing for dozens of multimillion-dollar deals and allegedly used a range of deceptive practices to avoid detection, such as asking other institutions to remove its name from transactions.

In October 2007, the US Treasury also designated Bank Mellī, Iran’s largest bank, for reportedly providing services to other banks and firms involved in the country’s nuclear and ballistic missile programs, including UN-designated entities such as Bank Sepah and its missile clients. According to the Treasury, after Sepah’s designation under UNSCR 1747 (adopted on 24 March 2007, which extended existing sanctions on Iran), Mellī took special measures to avoid identifying the bank in transactions. Treasury has also disclosed that Mellī facilitated the purchase of sensitive materials for Iran’s nuclear and missile programs by “opening letters of credit and maintaining accounts”.

In addition, according to the Treasury, from 2002 to 2006, the Iran government reportedly used Bank Mellī to send at least USD100 million to Iran’s Islamic Revolutionary Guards Corps – Qods Force (IRGC-QF), a special unit of Iran’s IRGC whose mission is to organize, train, equip and finance Islamist movements around the globe. “When handling transactions on behalf of the IRGC, Mellī employed deceptive banking practices to obscure its involvement from the international banking system,” the Treasury noted, including requesting that its name be removed from financial transactions.

In total, the US government has designated 20 of Iran’s 30 banks for their role in proliferating weapons of mass destruction or facilitating

terrorism, according to the Treasury Department's Office of Foreign Assets Control's Specially Designated Nationals list. Treasury's Financial Crime Enforcement Network has blacklisted all 30 Iranian banks for engaging in money laundering and abusing the international financial sector.

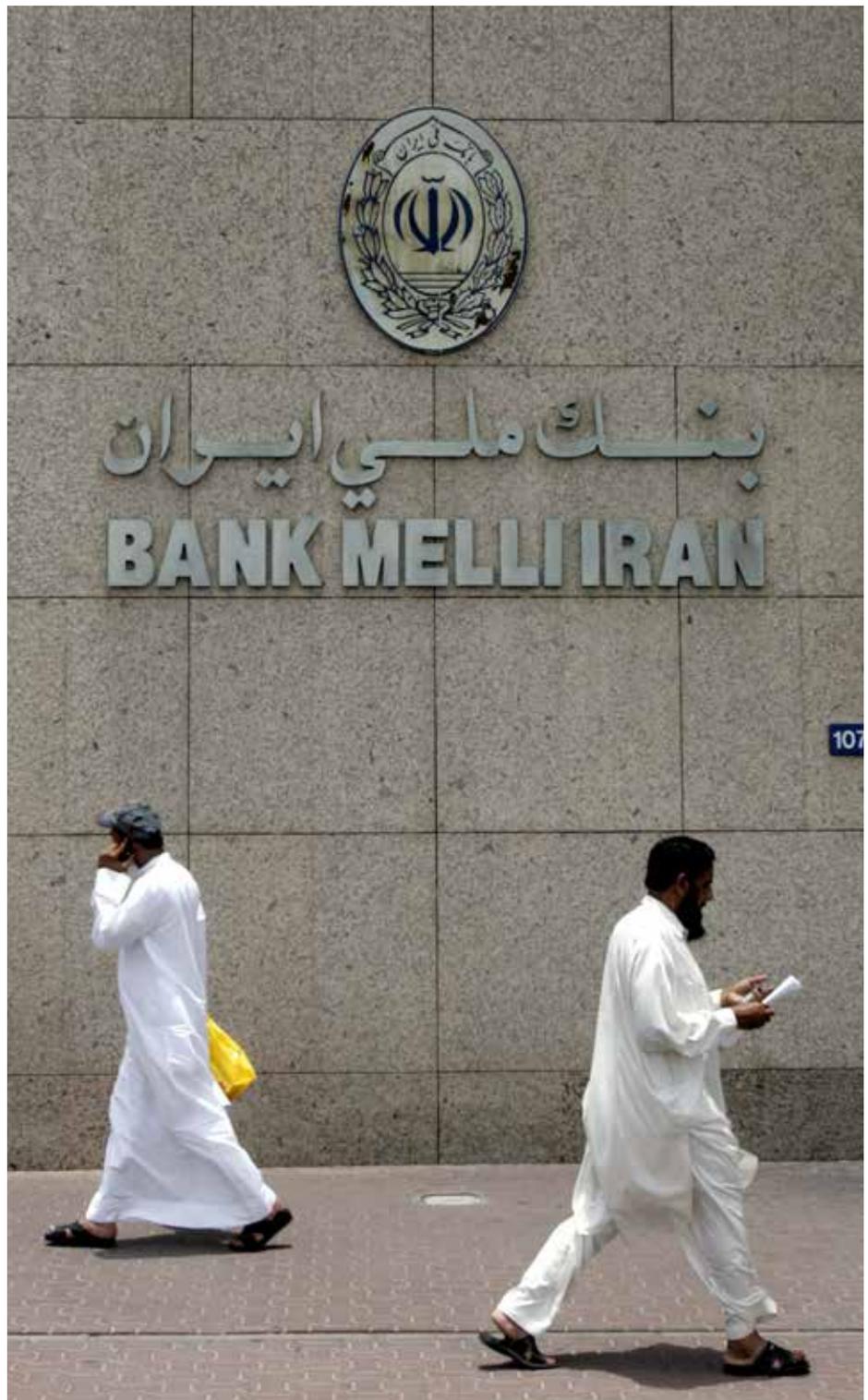
If the international community continues its existing approach, the Iranian government will undoubtedly be able to produce and purchase the materials necessary to continue and further develop its nuclear weapons program. Although no measure – with the possible exception of military strikes targeting the Iranian nuclear program and assets – can halt Iran's uranium enrichment activities, the US government and its allies can take steps to limit the regime's ability to obtain hard currency and access international financial markets. In so doing, they could make it much more difficult for Iran to pursue nuclear weapons and sponsor terrorism.

Case study 2: United Arab Emirates

In a March 2012 *International Narcotics Control Strategy* report, the US Department of State highlighted the susceptibility of the UAE to money laundering activities. "Its robust economic development, political stability and liberal business environment have attracted a massive influx of people, goods, and capital, which may leave the country vulnerable to money laundering activity. Dubai, especially, is a major international banking and trading center," the report said.

Indeed, the UAE has developed a reputation as a regional hub for money laundering and terrorist financing (ML/TF) activities, serving elements as disparate as mob figures, arms dealers, drug traffickers, diamond traders, underground money brokers and jihadists. All of these illicit actors have been known to engage in money laundering, and while the UAE has taken steps to enhance its AML/CFT efforts, its ability – and desire – to prevent and address these activities is limited.

The UAE possesses an advanced, but lightly regulated, financial services sector. Each of the emirates has an abundance of informal financial networks, known as hawaladars. Moreover, the UAE is a cash-based society and a heavy trader of precious metals, especially gold. Illicit actors exploit these characteristics, using gold and hawalas to move their money around the



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world with few restrictions or obstacles. These actors also seek to exploit the UAE's permissive smuggling environment, which is most conspicuous in Dubai. There, dhows – wooden boats that have been used for centuries to transport goods in this part of the world – are rarely inspected and often dock in an aptly named location, Smugglers' Creek, according to a 2005 article by *US News and World Report*.

The *9/11 Commission Report* published in 2004 also identified the UAE as an important node in financing the 9/11 attacks. Prior to the attack, Al-Qaeda moved money freely around the world using the Al-Barakat hawala network, which had headquarters in the UAE. In addition, a UAE money changer transferred funds to Marwan al-Shehhi, a UAE citizen who piloted United Airlines Flight 175 (which crashed into the South Tower of the World

Trade Center). Two of Osama bin Laden's sisters also reportedly used the UAE to smuggle cash to him in Afghanistan, while one of Bin Laden's financial chiefs, Shaykh Said (alias Mustafah Muhammad Ahmed) lived in Dubai and wired money to three of the terrorists before the attack. The funds were traced back to the Al-Ansari Exchange branch in Abu Dhabi. Ahmed has been incarcerated at Guantanamo Bay since 2006.

To its credit, the UAE has co-operated with international AML/CFT investigations and initiatives, including co-hosting a joint workshop held in Dubai in May 2012 organized by the UAE Anti-Money Laundering/Suspicious Cases Unit (AML/SCU) and the UK Crown Prosecution Service (CPS), which focused in part on AML challenges and initiatives in the UAE. The previous month, the UAE co-host-

ed with the US embassy in the UAE an AML training session for Pakistani government officials, *The Gulf Times* reported. According to Dr Al Sumaiti, the director-general of the Dubai Judicial Institute (DJI) who spoke at the event: "The session acts as an interactive platform to look into local and international experiences and discuss the AML system application challenges. It investigates current developments in the field of anti-money laundering, with a focus on top international practices and standards to reduce such a menace that has made a negative impact on the global economy."

The March 2012 US Department of State *International Narcotics* report also acknowledged that the UAE government has taken some specific, albeit limited, steps to address the conditions that facilitate money laundering and terrorist financing activities. For

instance, the Dubai Financial Services Authority (DFSA) released a lengthy commentary to DFSA-authorized firms and ancillary service providers on 20 June 2010 designed to ensure full compliance with UN sanctions introduced in mid-June to tighten restrictions on financial and shipping enterprises related to Iranian proliferation-sensitive activities.

DFSA outlined three specific actions to be taken by these firms in relation to correspondent bank accounts with Iran-domiciled banks, transactions with Iran-domiciled clients and wire transfers emanating from persons domiciled in Iran. These focused on: conducting risk assessments of direct correspondent relationships and customer due diligence with Iranian banks to ensure that Iranian banks have adequate internal controls to detect and prevent sanctions evasion; treating all transactions with clients domiciled in Iran as high-risk transactions, and obtaining sufficient information to avoid transactions that violate or evade sanctions, including identifying air/sea transportation companies used in transactions, specifically aimed at determining the direct or indirect use of Iran Shipping Lines (IRISL) vessels; and completing all information fields of payment instructions that relate to the originator and beneficiary of the transaction.

To date, the UAE has also signed memorandums of understanding (MoUs) with 40 countries, most recently in July 2012 with financial intelligence units in Kazakhstan and Ukraine during the 20th Egmont Group plenary session in St Petersburg, Russia, the *Khaleej Times* reported. These MoUs are designed to facilitate co-operation and information sharing between the UAE and others relating to money laundering and financing of terrorists. The previous month, on 21 June, the UAE National Anti-Money Laundering Committee (NAM-LC) led by the director of the AML/SCU also discussed establishing a trilateral committee with the US and Russia on exchanging information on the suspected financial flows into their respective countries, according to a press release issued by the Central Bank of the UAE.

Nevertheless, the UAE has yet to take meaningful action in curbing Iran's abuse of the emirate's financial sector, and continues to provide Iran with a critical gateway to access hard currency, goods and services and free use of many of its shipping ports. Indeed, several

areas require further action by the UAE government in order to deter money laundering activity. "The government should increase the capacity and resources it devotes to investigation of ML/TF both federally at the AML/SCU and at emirate-level law enforcement. AML/SCU needs to improve its timely financial information sharing capability to conform to international standards. The AML/SCU also needs additional resources to be able to execute its mandate of hawala supervision – currently it is not capable of supervising the vast number of hawalas in the country or enforcing hawala compliance," the US government concluded in its March 2012 report.

Conclusion

Only two weeks after the 9/11 attacks, President George W Bush addressed the media

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and declared “war” on terrorism financing. “Money is the lifeblood of terrorist operations,” he said. “Today, we are asking the world to stop payment.”

A few weeks later on 25 October, the administration launched an initiative referred to as Operation ‘Green Quest’, involving a special team of financial experts and law enforcement personnel to investigate how terrorists move money, the *Associated Press* reported. “The goal of [the operation] is to augment existing counter-terrorism efforts by bringing the full scope of the government’s financial expertise to bear against systems, individuals and organizations that serve as sources of terrorist funding,” said Deputy Treasury Secretary Ken Dam in a statement. “The same talent pool and expertise that brought down Al Capone will now be dedicated to investigating Osama bin Laden and his terrorist network.”



Superintendent Benjamin Lawsky of the New York State Department of Financial Services

Unfortunately, more than 10 years after these pronouncements, the war on terrorism financing and money laundering has stalled. This is clear even through the lens of the US government’s own bottom-line metrics – assets seized and forfeited, successful investigations and prosecutions, and effective sanctions.

Although it is impossible to eradicate illicit finance and associated criminal activity completely, improving the ability of the law enforcement and intelligence communities to “follow the money” would be more important than any battlefield victory. Cutting off illicit finance deprives terrorist organizations of their means of survival. Without adequate finances, terrorist groups will struggle to sustain their operations. As such, while law enforcement, intelligence officers, and military personnel are sometimes intimidated by the scale and complexities of terrorism financing and international money laundering, the most important counter-measure available to them is initiative. On the trail of terror or in seemingly routine criminal inquiries, all investigators must take the next step and ask: what about the money? ■

ABOUT THE AUTHOR

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