

# **Globalization, Terrorist Finance, and Global Conflict: Time for a White List?**

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## **I. 11 September 2001: Global Financial Transparency Under Construction**

When the terrorists trained by Osama bin Laden destroyed the two World Trade Center towers, their actions revealed both the globalization of terrorist finance, and the potentially Herculean task facing governments seeking to combat both it and other serious trans-border problems involving flows of money from illicit sources or for illicit purposes. Relying on a mere 500,000 USD in total expenditures, nineteen terrorists were able to enter the United States repeatedly, train as commercial pilots, engage in intercontinental air travel, rent cars, establish personal bank accounts, obtain ATM cards, and generally live adequately funded lives in the months prior to the attack. After 11 September, some of the funds involved were traced to an account in Dubai, a country that houses not only its own banks, but major US and European banks, banks from throughout the Islamic world, purely Islamic banks, alternative or underground remittance systems (hawalas), gold dealers, and myriad financial institutions handling transactions to such States as Iran and Iraq.

While little had been done to implement the standards at the time, Dubai was actually one of the very few countries in the Middle East (the others being Cyprus and Israel) to have even basic money laundering legislation in place. In theory, since the previous year, financial institutions in Dubai had been prohibited from taking anonymous funds for anonymous accounts, which previously had been lawful. By contrast, if one wanted to place funds for a terrorist from Saudi Arabia, for example, or from Bahrain, Yemen, Malaysia, Indonesia, the People's Republic of China, the

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Philippines, Nigeria, or Somalia, to name only a few, opportunities for anonymity would be wide-open. In these countries, there were effectively no limits on the anonymous placement of money, either in law or in practice, and indeed several of them retained a legacy of large numbers of anonymous accounts that could be freely traded as needed to practically anyone.

Sources of funds for terrorism were also little constrained. For Islamic terrorists, vast sums were available to those carrying out charitable work, including militant resistance, in Islamic outposts under siege – such as Bosnia, Kosovo, Kashmir, and Chechnya – donated by wealthy Gulf State Muslims giving zakir. Further funding was made available by siphoning off donations for more ordinary charitable work in many other jurisdictions within Islamic communities. These funds merely added to the seed money available on an ongoing basis from the proceeds of narcotics. Alternatively, terrorists have had numerous opportunities to generate revenues through fraudulent conversion of social benefits, migrant smuggling, document fraud, stealing cars, gun-running, or even working for the money. Thus, money, the life-blood of all kinds of organized crime, and regardless of its involvement in terrorist deposits and withdrawals has coursed rather freely through the veins of the global financial infrastructure.

Long before 11 September, other forms of financial scandal had demonstrated the ease with which criminals, drug traffickers, illicit combatants, guerrillas, and other persons and entities engaged in socially condemned behaviour have been able to launder their money. And repeatedly, governments, regulators, law enforcement agencies, and the most important and prestigious international organizations have found themselves unable to trace illicit transactions after something goes radically wrong.

Thus, terrorist finance can be seen from this perspective as a subset of a larger problem, that of non-transparent movements of money in a system to which much of the world has easy access. Financial non-transparency has facilitated not only terrorism, but also many of the world's more significant social ills, including civil war and civic instability. For example, the laundering of the proceeds of crime is a necessary means to carry out the trade in diamonds that has fuelled civil conflict in Liberia, Angola and Sierra Leone, together with their accompanying arms deals and payoffs. The narcotics trade has long been understood as a massive generator of illicit money to be laundered, as well as a generator of corruption and weakened governance. Drug trafficking is also closely associated with conflict, and one of the enduring factors in such conflict is the fact that drug funds sustain combatants in civil wars. It is no accident that each of the three countries which produce most of the world's opium and coca crops – Afghanistan, Burma, and Colombia – have ongoing insurrections fuelled by drug money, in which terrorist acts (or their equivalents) have become a common element of daily life.

The global attention focused on terrorism and terrorist finance as a result of the 11 September attacks on the United States provides a fresh vantage point on what has become an increasingly longstanding, significant problem. As an increasing number of significant global problems became linked to illicit finance, money

laundering was recognized in the 1990s as a global problem requiring a global response. Prior to 11 September, this response included new international instruments, such as the 2000 United Nations Convention to Combat Transnational Organized Crime and the Second Money Laundering Directive, issued by the European Union in late 2001. It has also included the rapid movement of 'name and shame' sanction programmes. Most prominent among these has been the Financial Action Task Force (FATF) against 'non-co-operative countries and territories'. In the first two years that the FATF threatened to limit market access to jurisdictions not meeting international standards, most of the nearly twenty targeted jurisdictions enacted new anti-money laundering laws. A similar exercise against 'unfair tax competition' undertaken by the Organization for Economic Cooperation and Development (OECD) is having a similar impact on ring-fencing, the strategy by which jurisdictions offer non-residents unregulated financial services, which they deny to their own citizens.

Major self-regulatory organizations, such as the Basel Committee for Banking Supervision (BGBS), the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS) also focused on extending standards for international regulation to cover transparency issues.<sup>1</sup> The new standards were designed to respond to the major failures of existing financial regulation to provide protection against illegal activities. Each organization focused on major gaps in the international regulatory system that translated into injuries to domestic supervision and enforcement. These gaps included:

- Fragmented supervision within countries by sector and among countries by national jurisdiction.
- Exploitation of differences in national provisions for regulatory arbitrage to circumvent more stringent national laws and international standards.
- Secrecy laws which impede the sharing of information among countries and between regulators and law enforcement.
- Inadequate attention to electronic payments in existing anti-money laundering supervision and enforcement, including 'know your customer' rules that focus on currency, even as the world's financial services businesses rapidly continue their move into e-money.
- The lack of international standards governing key mechanisms used in transnational financial transactions, such as international business companies (IBCs), offshore trusts, offshore insurance and reinsurance companies, and offshore funding vehicles, including but not limited to hedge funds.

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<sup>1</sup> See, e.g., Statement of the G-7, 18 June 1999; 'Strengthening the International Financial Architecture', Report of the G7 Finance Ministers, 18–20 June 1999; 'Financial Havens, Banking Secrecy and Money-Laundering', UN ODCCP, New York, May 1998; and numerous recent analytic documents of the Basel Committee available on the website of the Bureau of International Settlements (BIS).

- Minimal due diligence by company formation agents, attorneys, and financial institutions in the process of incorporating and licensing of new financial institutions and shell companies and trusts owned by their affiliates.

In response, there has been a convergence in the standards of protection in many countries against various simultaneous threats. In essence, the standards have begun to require a form of 'know your customer' at both the front end and the back end of any transaction. At the front end, bankers and other financial facilitators are now required to know with whom they are dealing, and at some level, what their customers have been doing with their money. At the back end, those permitting withdrawals of funds need to know not only who has been getting the money but also where it came from. That way, should something go wrong, it should be possible to trace the funds.

Despite these efforts, the globalization of money makes tracing increasingly more difficult.

Thus, the need to establish uniform standards, end bank secrecy, create mechanisms for the exchange of information between national regulators and law enforcement organizations with their counterparts, and the decision to 'name and shame' jurisdictions that failed to adopt and live by the new rules. In 1989, when the FATF was created, there was some scepticism about the ability of even OECD countries to agree on common standards, let alone to live by them. A decade later, when the FATF's non-co-operative countries and territories initiative began, common standards became comprehensive, and the consensus existed that they should be made universal. Thus, by 11 September, the name and shame exercises were well on the way to universality. Over time, the existing international initiatives in response to these problems began to create a new global code articulating new international standards for transparency. And yet, these initiatives failed to do much to prevent the September terrorists from carrying out their plans.

One could argue that these regimes are too new and incomplete to have had an impact, especially in a world where the proceeds of the world's largest extractive industry, oil, remained largely opaque despite all of the transparency initiatives. In this view, objectives are long-term and the belated response to the globalization of the financial infrastructure cannot be expected to fix long-standing problems overnight, especially in such regions as the Middle East, which only began to adopt the regulatory standards of more established international financial services centres.

However, it is also possible that the basic idea of a universal standard for all governments, given our global diversity, is inherently flawed. Each of the new initiatives has been based on the promise that national financial service regulators have the capacity to determine whether their own 'local' institutions meet the standards or not. Under the principle of consolidated supervision, the home-country regulator of any international financial institution is solely responsible for exercising oversight over the global operations of that institution. Over the past ten years, the principle of consolidated supervision has proven helpful but far from infallible in protecting safety and soundness by requiring multi-jurisdictional financial institu-

tions to take at least their home regulators very seriously. In turn, these home regulators are increasingly subject to a common set of standards, such as those established by the Basel Group of Bank Supervisors (Basel Group). Over time, these standards have come to promote global financial stability by promoting good practices for banks in their lending and investment practices. However, the same system has to date demonstrably failed to do much to protect the world from money laundering or terrorist finance.

## **II. The Capacity Problem**

Can governments that stop at borders regulate financial activity that crosses borders at the speed of light amid billions of electronic ones and noughts? Even if one does not consider the special problems posed by terrorist finance and the inadequacy of financial transparency regimes in the Middle East, there is mounting evidence to justify questioning whether global banks, operating transnationally to move money instantaneously across national borders, can be readily regulated or supervised by any one country. While such financial institutions may have their headquarters nominally based in a single country – typically one of the G-7 countries, the EU, or Switzerland – they generate profits and carry out activities at a global level involving dozens of UN Member States. As a result, they are for many purposes beyond the capacity of any single state to police. The current ‘name and shame’ exercises have had the salutary effect of forcing some of the world’s least-adequately regulated jurisdictions to abandon traditional notions of bank secrecy, and to begin insisting that their financial institutions carry out due diligence and know their customers. But these exercises have not and cannot create any capacity at a national level to assess the meaning and integrity of cross-border financial transactions. It is not reasonable to expect a small jurisdiction that houses a subsidiary of a major international financial institution to fully understand the cross-border transactions engaged in by the subsidiary, let alone by its affiliates or far-away parent. In practice, even the most sophisticated and best regulated financial centres, including those of the G-7, European Union, and Switzerland, are similarly incapable of exercising adequate oversight over the global enterprises they license.

In recent years, the proposed solution has been a mixture of public sector regulation and private sector self-regulation. Self-regulation has been advocated as a means by which private institutions subject to market forces will, as a matter of good business, avoid transactions that are exposed on that institution or its reputation to undue risk. However, it is not clear that this approach has been effective. Indeed, the combination of both government regulation and self-regulation has not to date effectively discouraged abuse of international financial institutions by drug traffickers, terrorists, major financial criminals, corrupt officials, arms smugglers, or sanctioned regimes, not to mention those engaged in



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