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Subcommittee on Counterterrorism and Intelligence
“Terrorist Financing Since 9/11:
Assessing an Evolving al Qaeda and State Sponsors of Terrorism”
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Chairman Meehan, Ranking Member Higgins, and distinguished Members of the subcommittee, thank you for the opportunity to appear before you to discuss the critical issue of terrorist financing. As the disrupted airline bombings plot out of Yemen last week indicates, terrorist threats to the United States persist notwithstanding the death of Osama bin Laden and decline of the hierarchical organization of al Qaeda.

My comments are based on my previous experience as Assistant Secretary of Commerce responsible for regulating dual use goods and technology, as well as more recent academic initiatives to strengthen the instrument of UN sanctions. Currently, my colleague at the Graduate Institute in Geneva, Thomas Biersteker, and I are leading the *Targeted Sanctions Consortium*, an international group of scholars and practitioners conducting a comprehensive and comparative analysis of the impacts and effectiveness of UN sanctions, including those targeted on al Qaeda and affiliated groups, as well as sanctions against Iran and DPRK. I’ve also worked with the United Nations Counterterrorism Implementation Task Force to explore the identification of indicators that might be useful to financial institutions in detecting potential terrorism financing activity. In this regard, I’ve had the opportunity to interact with the private sector, national regulators, and international counterterrorism policymakers involved in the global effort to combat the financing of al Qaeda and affiliated groups. The views expressed however, are my own, and not necessarily endorsed by any entity or colleagues with whom I am affiliated.

Due to time constraints, this abbreviated statement focuses on terrorism financing related primarily to al Qaeda (AQ) and lays out some considerations for ways forward. I am happy, however, to provide an expanded statement based upon our book, *Countering the Financing of Terrorism*, and more recent initiatives assessing the effectiveness of UN sanctions.

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Evolving Threat and Means of Financing

Al Qaeda today is profoundly transformed from the group that engineered the attacks on 11 September 2001. The once-hierarchical organization evolved into a confederation of allied entities, and subsequently into a general jihadi movement, with al Qaeda core (AQC) serving more as an inspirational vanguard, a source of legitimization and justification for acts of global terrorism by affiliates, rather than as a source of the planning, financing, and execution of terrorist attacks. Regional affiliates such as AQ in the Arabian Peninsula (AQAP), AQ in the Islamic Maghreb (AQIM) and al Shabaab in Somalia, now outnumber AQC remnants in Pakistan and remain committed to al Qaeda ideology. Even with new revelations about bin Laden's final activities in Abbottabad, the AQ affiliates constitute the more significant contemporary terrorist threat.

Likewise, the means by which terrorists finance activities have changed, and today largely consist of criminal means conducted within a state. Formal sector transactions and even the transnational movement of funds by AQ have been severely constrained, in part due to the success to the extensive global efforts to counter the financing of terrorism (CFT). Formal sector financial institutions generally have not been used for the transfer of funds across international borders to AQ since 2003; rather, AQ affiliates have increasingly resorted to the use of cash couriers and barter trade to move funds. Self-financed criminal activities such as credit card and check fraud, theft, extortion, and kidnapping for ransom represent more common methods utilized by terrorists to finance their activities.¹ Charitable donations as a significant means of financing terrorism also appears to have diminished, as recent evidence concerning the diversion from Islamic charities is lacking (and most of the legal cases resulting in successful convictions have been based more on violations of tax and reporting rules, rather than terrorist financing). While informal value transfer systems or hawala were used for the transfer of funds prior to the attacks of 11 September and most recently by the Times Square bomber, the overwhelming majority of such transfers are legitimate and advance important social and global developmental functions.

Recognition of the changing structure and financing of AQ and affiliated groups is important, as effective strategies for countering the financing of terrorism must similarly adapt to the current threat. With more than a decade of CFT experience, now is an opportune time to take stock of what has been accomplished in order to recalibrate US and international efforts to more effectively address the evolving nature of terrorist financing. I commend the subcommittee for focusing on this issue, and hope additional review will be undertaken.

In this regard, it is worth remembering that prior to 9/11, there was little concerted attention focused on terrorist financing, with al Qaeda able to raise funds from donors in Gulf States and charitable organizations and move them through financial institutions. Few requirements other than those mandated by UNSCR 1267 existed to restrict financing, with almost no emphasis on implementation (indeed, country reports prior to 2001 largely consisted of one sentence – “We

¹ Note that this is not the case with the Taliban which has adapted over time in Afghanistan and Pakistan, in large part due to territorial control facilitating revenues through taxation of drug production, transiting goods, diversion of international assistance, and ransom from kidnappings.

have taken all necessary steps to comply with the resolution.”) In the past decade, there has been a sea-change in the recognition and implementation by Member States of legal, administrative, and enforcement measures to combat terrorism financing.

CFT Developments and Challenges

Since 9/11, we’ve witnessed an impressive global initiative to disrupt financial support for terrorism. The US has worked diligently to launch a worldwide campaign to make it more difficult, costly, and risky for AQ and affiliated groups to raise and move money around the world. As a result, new and significant international institutional frameworks have evolved to address CFT, including crucial roles by the United Nations Security Council, the Financial Action Task Force, the World Bank, IMF, Egmont Group, as well as private sector initiatives like the Wolfsberg Group. UN Security Council Resolutions 1267, 1373, and 1540 (and successor resolutions) provide the legal basis and legitimacy for Member States to take necessary steps to put into place national legal and administrative mechanisms to freeze terrorist assets. Multilateral CFT efforts have been essential in stemming terrorist funds.

The global CFT regime utilized preexisting policy instruments but greatly expanded them. Through designations or listings of individuals, organizations, and corporate entities and the freezing of their assets, CFT efforts have primarily focused on preventing the use of formal sector financial institutions for the trans-border transfer of funds that could be used to support acts of terrorism. Initiatives to license informal value transfer systems and register charities have also resulted.

Notwithstanding the important accomplishments of terrorism sanctions to date, complications and unintended consequences have arisen. National and regional courts have faulted the UN process of designating individuals as well as with the adequacy of procedures for challenging those designations. Perceptions of unfairness in the application of targeted sanctions and potential violation of due process have generated concern and public opposition in several countries, including among legislatures, threatening to undermine the credibility and effectiveness of UN targeted sanctions. The most prominent case of Saudi businessman Yassin Abdullah Kadi, is still under appeal at the European Court of Justice, but if successful could force the EU not to implement mandatory Chapter VII sanctions thereby establishing a dangerous precedent and potentially undermining UN terrorism sanctions. Notwithstanding important procedural enhancements in recent years, however, legal challenges persist. This problem cannot be “solved” definitively, but rather must be managed to dissuade national or regional courts from questioning the underlying security rationale for listings. Continued review of UN designations and innovations in the delisting process are necessary for the legitimacy of international CFT measures and the future utility of the instrument of multilateral sanctions.

The freezing of assets or exclusion from the international financial system are indeed powerful terrorist financing tools, but such measures can have far-reaching consequences. Fears that there would be a decline in charitable contributions to Muslim charities have been realized to an extent, which could have implications for efforts to address root causes of terrorism. Targeted financial sanctions are not as targeted as they might initially appear; in the case of al Barakaat, the collateral damage of freezing the assets of the broad group of companies led to severe

disruption of fund transfers to a large portion of the Somali population. Concerns for the risks involved with money service businesses (MSBs) resulted in the shuttering of Somali MSBs in several states, leaving large diaspora communities without viable means to transmit money cheaply and efficiently to relatives since there is no functioning banking system in Somalia.

Moreover, the regulatory burden on financial institutions has increased considerably. Compliance with enhanced reporting requirements, new internal procedures to screen customers, and train staff to block or freeze individual transactions have escalated costs as responsibility for CFT implementation rests primarily with the private sector. In addition, banks have terminated relationships with perceived risky sectors – MSBs, embassy banking and certain correspondent banking relationships, resulting in the labeling of some sectors as “unbankable.” The dramatic increase in the volume of information submitted by financial institutions, including the millions of SARs filed annually, which remain largely unanalyzed and continues to be a source of frustration to financial institutions. Processing information is far more important than simply accumulating it, and it is important that regulation be prudently designed with this in mind.

Likewise, the success of CFT instruments ultimately depends on parallel implementation by other countries. Despite progress since September 11, serious deficiencies of capacity within Member States to implement CFT measures exist (e.g. to criminalize terrorist financing, prohibit financial support to terrorists, and freeze the assets of those who commit or support terrorist acts). Implementation is uneven, and in some states, capacity is virtually nonexistent. Enhanced initiatives to assist countries in building the legal and administrative infrastructure to implement and enforce financial sanctions are necessary.

Overall, however, CFT efforts have constrained AQ and its affiliates in their ability to access essential support. As noted by the 1267 Monitoring Team in a recent report, financial sanctions have among other things, restricted the ability of those listed to continue to promote the objectives of AQ and their associates, alerted law enforcement to the activities of listed parties, and signaled to the world (and other potential financiers of terrorism) the resolve of the international community to combat funding of terrorism. While far from perfect and with much more that can and should be done to strengthen CFT measures, it is important to keep these accomplishments in mind – indeed, the glass is more than half full!

Considerations for the second decade of CFT initiatives

As the US and the international community move forward to strengthen CFT policies in the coming years, the following considerations are useful to keep in mind:

- The importance of realistic expectations as to what financial sanctions can reasonably achieve. Terrorism will continue, and AQ still exists (with access to funds). This does not mean that TF initiatives are ineffective, but rather we must be cognizant of the appropriate role of TF sanctions play as but one element in a larger CT strategy.
- When assessing the impact and effectiveness of CFT measures, it is essential to appropriately define the purposes. An innovation of the *Targeted Sanctions*

Consortium's methodology² includes evaluating effectiveness of sanctions in terms of multiple and differing purposes of sanctions, to: 1) coerce or change targets' behavior; 2) constrain terrorist activities (or access to essential resources such as funds thereby raising costs and forcing changes in strategy), and 3) signal/stigmatize targets violating international norms through terrorist acts.

- While progress has been made in CFT, terrorists are constantly evolving the means by which they raise and use funds; the international response needs to be dynamic as well. The basic framework focusing on preventing the use of formal sector institutions for cross-border transfers of funds remains largely unchanged. New strategies and tools to address current financing (e.g. cash couriers, stored-value instruments, informal value transfer systems (IVTS), kidnapping etc.) are necessary.
- CFT measures are considered among the most "effective" sanctions, yet there is public perception that sanctions generally are not effective. More needs to be done to demonstrate and make the case regarding the effectiveness of TF sanctions.

With terrorists' evolution of financing means, it is critical to continually review and adapt US and international CFT responses. Military planners are famous for preparing for the last war, and it is important that those concerned with countering the financing of terrorism not make such a mistake. Al Qaeda has changed. The nature of its fundraising has changed. The ways in which it moves, stores, and uses funds have changed. It is important that CFT efforts proceed from this knowledge, rather than squander limited resources.

The following are general areas that could be considered in future efforts to strengthen CFT measures:

Enhanced information and analysis

The old adage - the more you know, the more you realize how much you don't know – applies amply to the subject of terrorist financing. There is still a great deal we do not know, for example, regarding the use of informal value transfer systems, trade diversion, traditional cash smuggling, and new electronic payment methods through cell phones, stored value cards, and digital currencies. Notwithstanding greater understanding regarding AQ's financing of terrorism, and "despite all of our sophistication, we have neither starved the beast nor produced very good intelligence on how exactly these organizations continue to finance themselves," as Lee Hamilton noted. There is a significant need for the further research and analysis in this area.

Differentiate among groups and means to finance terrorist operations

² For more information about the *Targeted Sanctions Consortium*, a comprehensive, systematic, and comparative assessment of the impacts and effectiveness of UN targeted sanctions regimes over the past twenty years, see http://graduateinstitute.ch/internationalgovernance/UN_Targeted_Sanctions.html

It is important that CFT initiatives distinguish between (and differentiate among) groups committing acts of terrorism. Those acting on a global scale, like AQ, have different needs and means of financing themselves, particularly when they are compared to groups acting on a local or regional scale. Territorial-based groups can extract resources in ways that approximate the state (i.e. Taliban exacting tariffs or quasi-taxes from the population). There are fundamental differences in the goals, scope of operations, and the ultimate objectives of groups acting globally and groups contained within a defined territorial space. Extending existing CFT efforts aimed at al Qaeda to other circumstances risks diffusing the effort and decreasing effectiveness. One size does not fit all.

Develop Metrics

There are relatively few quantitative indicators and reliable sources of information to assess CFT initiatives but it would be useful to try to devise additional metrics of effectiveness. Metrics most commonly associated with terrorist financing - the total number of designations and the amount of money frozen - are inadequate and can be misleading. As difficult as such an endeavor would be, it is important to attempt to assess the effectiveness of CFT efforts. The consequences of failing to do so are inappropriate and potentially ineffective policies to thwart terrorist acts. Policymakers and academics alike must demand better and more transparent sources of information in order to more thoroughly understand and assess terrorist financing efforts.

Evaluate and analyze TF information

As noted by others, FinCEN receives nearly a million Suspicious Activity Reports (SARs) from financial entities annually, of which less than 1% relate to TF, yet little systematic analysis of the information results. FinCEN generally passes SARs on to the FBI who integrates the information into their database in order to identify trends and suspicious transactions. However, the current system lacks requirements for the systematic analysis of data to be able to discern patterns that could assist FIs in screening for terrorist-related transactions.³ The same applies to sharing of case information at the international level through which comprehensive analyses, lessons learned, policy-useful conclusions and guidance for both government agencies and the private sector could possibly emerge. Is it an issue of resources or lack of priority? What could and should be done to most effectively mine the information reported by FIs? USG officials have previously referenced the number of cases in which financial information from SARs played a role; this information should be updated and made available.

TF prosecutions

Successful prosecution on TF grounds are limited – in many cases of suspected financing, convictions are easier to obtain on alternative charges. Should we be concerned with the relatively small number of successfully prosecuted TF cases? What are the obstacles, and are legislative changes needed?

³ An initiative by a group of researchers to collect and analyze examples of terrorist financing (TF) through financial institutions in order to discern indicators of terrorism finance was stymied by the lack of access to information (sanitized SARs redacted of identifying info which DoJ was willing to provide).

Collaboration/information sharing with financial sector

Despite ten years of espousing the need for closer public-private partnership to combat TF, the two-way exchange of information remains limited – in most cases, it's the financial community providing input with very little feedback. The FBI created a financial sector working group that meets periodically, but compliance officials still complain about a lack of information to help detect terrorist transactions. Analysis of SARs information that aided in law enforcement investigations could help FIs identify typologies and trends they should be alert to.

The UK has instituted a system whereby select representatives of financial institutions receive security clearances so sensitive information regarding transactions can be share. A similar initiative has been discussed in the US, but little progress seems to have been made. Is this a good idea, and if not, why not? What are other ways in which the USG can collaborate with financial institutions? Are additional protections (i.e. safe harbor provisions) needed?

Notwithstanding the absence of reliable terrorism financing indicators, the information provided by financial institutions remains critically important to intelligence and law enforcement efforts to disrupt terrorism. When intelligence on possible terrorist activities is shared with financial institutions, the information they provide is often vital and unavailable from other sources. New initiatives to enhance information-sharing between governments and the private sector should be prioritized.

Address inadequate CTF capacity in other countries

To be effective, CFT measures must be implemented in a comparable manner by other countries. While the UN is an important source of legitimacy (requiring member states to criminalize the financing of terrorism and to freeze the assets of individuals/entities designated as terrorists) only Member States can put into place the necessary legal, administrative and enforcement measures to counter TF. Even with successes as noted, there remain significant deficiencies in the capabilities of many Member States to meet their international CFT obligations (to criminalize terrorist financing, prohibit financial support to terrorists, and freeze the assets of those who commit or support terrorist acts). More needs to be done to provide adequate assistance for MS to put into place the necessary legal, administrative, and compliance measures, and current initiatives should be enhanced

Great public awareness and understanding of CTF initiatives

There is a need for broader understanding of the importance and utility of CFT measures, both designations and terrorist financing tracking. Most information regarding the reasons for designations and the effectiveness of the CFT in identifying networks or preventing acts of terrorism is closely held by government agencies. While protection of sources and methods is necessary, excessive classification and lack of documentation to justify designations undermines public confidence in, and support for, the CFT regime.

Critical assessment of CFT effectiveness

Ultimately, the effectiveness of national and global efforts to counter the financing of terrorism depends on the nature of the threat (the assessment of risk) and the appropriateness of the response to that threat (i.e. that the benefits of the policy response outweigh the costs of the measures enacted). When it comes to an assessment of the benefits of CFT efforts, there is strong evidence that it is more difficult for AQ and affiliated groups to use the formal financial sector to support operations today. The capacity of AQ and others to commit acts of terrorism has been degraded. Yet there is little systematic assessment of the costs and limitations of the current approach. “Staying the course” of current policy may not be the most appropriate action, especially given the changing and adapting nature of al Qaeda.

Beyond these general areas, specific consideration should be given to:

Charities - Traditionally, al Qaeda and other groups have utilized charities, NGOs, and mosques to raise funds through direct solicitations and diversion of donations intended for humanitarian purposes. While the risk of abuse of the charitable sector remains real, a differentiated approach, distinguishing between financing humanitarian networks affiliated with resistance groups and financing terrorism, is needed. Blanket condemnation of groups providing social welfare services alienates Muslim constituencies and prevents aid from reaching those most in need. Government efforts should focus on assisting charities to be more transparent; clarifying what constitutes financing of terrorism and association; designating independent bodies to regulate and investigate charities; and accrediting charities or developing indicators of trust/approval so that contributors know the group can be trusted to deliver support to appropriate projects.

In addition, *zakat* contributions are central to the practice of Islam, and a policy that places charitable giving to Islamic organizations under general suspicion contributes to a perception that the effort is directed against the entire Muslim community, rather than a very small segment of that community. Not only is this profoundly unfair, but it will ultimately undercut the effectiveness of other counter-terrorism efforts. Special effort must be taken to reaffirm support for charitable giving through transparent processes.

Informal Transfers - Regulation of remittance vehicles is necessary, but should be done in a way that is proportionate to risk and appropriate to particular socio-economic environments. In countries where informal systems exist alongside a well functioning conventional banking sector, *hawala* or other informal value transfer systems (IVTS) should be registered and required to keep adequate records. In states at risk of institutional collapse or states without functioning banking systems, requirements beyond registration may not be feasible. Governments should conduct outreach efforts to consult, engage, and build consensus among IVTS operators with regard to the most appropriate measures. Positive incentives should be created for participants in the sector to implement regulatory frameworks. In this regard, greater emphasis should be placed on the traceability of transactions, rather than centralization of data and should be sufficiently flexible so as not to drive IVTS underground.

Trade Diversion - International trade is vulnerable to abuse by terrorists, as well as other criminals, through false invoicing and the use of commodities to move funds, yet relatively little attention has been focused on this mechanism. Governments need a more concerted focus on trade diversion, both through greater understanding of the threat posed by lack of trade transparency and the techniques used, as well as specific efforts directed at anticipating,

detecting, and thwarting attempts by terrorist groups or their supporters to take advantage of this mechanism. Trade transparency units to analyze, share, and track international trade data to identify anomalies have been formed, albeit more slowly than hoped. Greater cooperation with the private sector victimized by diversion schemes should be explored, and enhanced priority placed on interagency cooperation and prosecution of trade diversion cases.

Since 9/11, an impressive global effort to regulate the trans-border movement of funds through formal sector financial institutions has ensued, but AQ and other groups have adapted and developed alternative means to raise and move funds to continue their terrorist activities. In order to be effective, CFT policies continually must be reassessed and recalibrated. Genuine partnership between the private sector and government is critical to effective CFT policies, and new ways of sharing information and creating incentives for compliance must be explored.

Thank you for the opportunity to discuss terrorist financing since 9/11 – I look forward to questions and being of assistance to the Committee.