

**Money Laundering Controls and Terrorist Finance**

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One of the most troubling facts about international terrorism is just how little money it requires to create havoc. Notwithstanding early stories about the Bin Laden fortune, rumored to be in the hundreds of millions of dollars, we now know that individual operations involve typically merely tens of thousands of dollars. For the East African Embassy bombings in 1998, among the five deadliest incidents to date, the costs were truly paltry, estimated at only \$10,000. The September 11 Commission, in its monograph on the financing of the Twin Towers bombing, estimated that the total cost was only \$400-500,000, even though it involved a large number of operatives and a very long planning horizon.

This presents a major challenge to the elaborate system of anti money laundering controls (AML) that the United States and other nations have constructed over the past twenty years. The AML regime was originally designed to deal primarily with drug traffickers, who handle large quantities of actual cash. It has since been extended for a variety of purposes, including to help discourage corrupt officials in developing countries from ripping off their citizens. It focused on the vulnerability of having to turn this criminal cash or bribes into forms that can be used more discreetly and efficiently to buy condominiums in Miami and jewelry in Zurich.

Thus the AML regime was focused on what is called the “predicate crime” and preventing black money being converted into white. That is of course almost the opposite of the problem for terrorist finance. Much of the money going to the terrorist organizations is legitimately earned and perhaps even innocently dispatched; it is the purpose for which it will be used that is the problem. Just as important the amounts involved are so small that they are buried in a vast population of similar-size transactions. Controls have to be very intrusive to reach transactions of less than, say, \$5,000. The 9/11 Commission financing report observed: “The money-laundering controls in place at the time were largely focused on drug trafficking and large-scale financial fraud and

could not have detected the hijackers' transactions. The controls were never intended to, and could not, detect or disrupt the routine transactions in which the hijackers engaged."

At the time of the Twin Towers tragedy, it was impossible for the federal government to query the financial system for information on a specific individual. Even knowing that Mohammad Atta was a target, the Department of Justice would not have been able to quickly check whether there were any accounts in his name. That has changed. The Patriot Act has given the U.S. government the ability to track individuals in the financial system. Starting with a name, federal agencies can, in principle, query a huge number of financial institutions as to whether they have any records in the names of the suspects. There appear to be instances in which that authority has been used successfully to catch a terrorist suspect through the financial system and prevent an incident.

Beyond simply responding to government queries associated with a particular name, could banks affirmatively identify possible terrorist financing operations from patterns of transaction? Again the September 11 Commission in its 2004 report was blunt in reporting the experience to date. "Efforts within the financial industry to create financial profiles of terrorist cells and terrorist fund-raisers have proved unsuccessful, and the ability of financial institutions to detect terrorist financing remains limited." Perhaps better computer systems will produce something more effective. However there are probably too few instances of proven terrorist financing to provide a database of sufficient size to develop a profile. Given that the problem is at the other end, the pattern of terrorism financing may indeed not be distinctive.

The interesting question is whether the mainstream controls associated with the Bank Secrecy Act, the Money Laundering Control Act and sundry other laws which affect so many businesses, plays a useful role here, since terrorism is the principal concern driving the expansion of the AML system now. Not just banks but casinos, life insurance companies and broker-dealers are all subject to fairly complex regulations; large jewelry stores have just acquired some reporting responsibilities as well. There is a modest flow of Suspicious Activity Reports with information on suspected terrorist activities.

The international rule setting body, the Financial Action Task Force (FATF) recommended in 2003 the expansion of the prevention pillar of the AML regime to a still broader array of financial and non-financial businesses and to certain professions. One current frontier of regulation in the United States is real estate agents, but the AML regime may well move beyond them to any person or business dealing in large volume purchases, as is already the case in Britain. Dealers in antiques, rare postage stamps, or jewelry would be required to file reports when any customer uses more than \$10,000 in currency for a purchase or when there is something “suspicious” (a notoriously vague and variably interpreted term) about an actual or potential transaction.

The AML system has worthy goals but it also imposes real costs. The obvious ones – U.S. government expenditures on operating the Currency Transactions Reports (CTRs) and Suspicious Activity Reports (SARs) programs-- are a small part of the regime’s total costs. Firms subject to the reporting requirements have to invest in systems to identify customers and transactions and to deliver reports. They in turn subject customers to costs and inconvenience by requiring additional information and time for verification. Our very rough estimate of the total financial cost of the current system in the United States was about \$7 billion in 2003, including costs borne by the government, financial and non-financial private sector institutions, and the general public. Moreover there are the much more subtle costs in the form of errors, individuals and businesses that are tarred incorrectly with the money laundering brush as well as denied prompt access to their funds.

Money laundering controls can clearly play a role in preventing terrorism, primarily in the investigation of incidents and links to terrorist organizations. The lack of large numbers of Suspicious Activity Reports or low volumes of money seized do not prove that the system is not working. Terrorism is a major problem but volume of financing terrorist organizations receive through the regulated financial sector is not the right measure of that problem. The task for governments is to determine what parts of the huge structure that has been constructed are making real contributions to combating the financing of terrorism.