

LEBANESE AMERICAN UNIVERSITY

The New Financial War: Lebanon and Its Anti-Money Laundering and
Counter-Financing of Terrorism Regime, Regional and International
Engagements

By

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A thesis submitted in partial fulfillment of the requirements for the Degree of Master
of Arts in International Affairs

School of Arts and Sciences

February 2013



Lebanese American University
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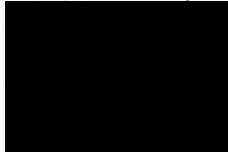
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Acknowledgements

I would like to thank my advisor Dr. Jennifer Skulte-Ouaiss for her patient support and knowledgeable guidance. I am also thankful to Dr. Sami Baroudi and Dr. Imad Salamey for their time and contribution to the panel. Finally, my thanks go to Mirna and Bassam for their generous reviews and my loving family.

The New Financial War: Lebanon and its Anti-Money Laundering and Counter-Financing of Terrorism Regime, Regional and International Engagements

Waddah M. Safa

Abstract

This thesis examines the potential for conflict between domestic Lebanese political (and other) pressures and international pressures that is a direct result of globalization. This conflict is further highlighted by the nature of the topic at hand: money laundering and financing of terrorism, which have seen significant growth due to globalization. It also analyzes how the U.S. money laundering laws have impacted international anti-money laundering laws and ultimately similar laws and policies in Lebanon. It examines how the latest efforts to develop efficient strategies for anti-money laundering and combating the financing of terrorism has led to the establishment of financial intelligence units combining several diverse but unified aspects of financial systems and law enforcement. This research also provides a summarized account of Lebanon's anti-money laundering and combating the financing of terrorism regime. Through policy and discourse analysis, it explores the behavior of the Lebanese financial system in crises showing how the Central Bank's timely intervention in problematic situations has resulted in leveling international and domestic political pressures. The main question is: How has Lebanon sustained its leading role as one of the most important financial and banking centers in the Middle East based on its longstanding banking secrecy practices as well as complied with international standards regarding anti-money laundering and combating the financing of terrorism; it is hoped that this thesis provides an informative and plausible answer.

Keywords: Lebanon, Money Laundering, Terrorist Financing, U.S., Globalization

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List of Acronyms

AML – Anti-Money Laundering
BCC – Banking Control Commission
BCCI – Bank of Credit and Commerce International
RO – Beneficial Right Owner
BSA – Bank Secrecy Act
CBRS – Currency Banking Retrieval System
CDD – Customer Due Diligence
CFR – Code of Federal Regulations
CFT – Counter-Financing of Terrorism
CFTC – Commodity Futures Trading Commission
CIA – Central Intelligence Agency
CTC – Counter-Terrorism Committee
CTS – Cash Transaction Slip
CUNA – Credit Union National Association
DHS – Department of Homeland Security
DNFBPs – Designated Non-Financial Businesses and Professions
DOJ – Department of Justice
EBIC – European Banking Industry Committee
EC – European Commission
ECC – European Economic Community
EDD – Enhanced Due Diligence
EO – Executive Order
EPCA – Emergency Post-Conflict Assistance
EU – European Union
FATF – Financial Action Task Force
FBI – Federal Bureau of Investigation
FDIC – Federal Deposit Insurance Corporation
FinCEN – Financial Crime Enforcement Network
FIU – Financial Intelligence Unit
FRB – Federal Reserve Board
FSRBs – FATF-Style Regional Bodies
FTATC – Foreign Terrorist Asset Tracking Center
GCC – Gulf Cooperation Council
GDP – Gross Domestic Product
ICRG – International Cooperation Review Group
IGOs – Inter-Governmental Organizations
IMF – International Monetary Fund
INCSR – International Narcotics Control Strategy Report
IPE – International Political Economy
IR – International Relations
IRS-CID – Internal Revenue Service-Criminal Investigation Division
JTTF – Joint Terrorism Task Forces
KYC – Know Your Customer
LCB – Lebanese Canadian Bank
LCCs – Low Capacity Countries
MENA – Middle East and North Africa
MENAFATF – Middle East North Africa Financial Action Task Force

MLATs – Mutual Legal Assistance Treaties
NCCTs – Non-Cooperative Countries and Territories
NGOs – Non-Governmental Organizations
NSA – National Security Agency
OCC – Office of the Comptroller of the Currency
OECD – Organization for Economic Cooperation and Development
OFAC – Office of Foreign Assets Control
OTS – Office of Thrift Supervision
PEPs – Politically Exposed Persons
PSD – Private Sector Dialogue
RBA – Risk-Based Approach
RRGs – Regional Review Groups
SAR – Suspicious Activity Report
SDGT – Specially Designated Global Terrorists
SEC – Securities and Exchange Commission
SIC – Special Investigation Commission
STR – Suspicious Transaction Report
SUAs – Specified Unlawful Activities
SWIFT – Society of Worldwide Interbank Telecommunication
TBML – Trade-Based Money Laundering
TFOS – Terrorism Financing Operation Section
UANI – United Against a Nuclear Iran
UN – United Nations
UNIIC – United Nations Independent Investigation Commission
UNSCR – United Nations Security Council Resolution
USA PATRIOT Act – Uniting and Strengthening America by Providing Appropriate
Tools Required to Intercept and Obstruct Terrorism Act
WB – World Bank
WMDs – Weapons of Mass Destruction

CHAPTER ONE

INTRODUCTION

1.1 Background

“In the aftermath of the 9/11 terrorist attacks, the U.S. administration pressured the United Nations to adopt tough measures to suppress the financing of terrorism. And on September 28, 2001, the U.N. Security Council adopted Resolution 1373. Invoking Chapter VII of the U.N. Charter, Resolution 1373 called on all states to prevent and suppress the financing of terrorist acts and to criminalize the willful provision or collection ... of funds by their nationals or in their territories with the intention that the funds should be used ... to carry out terrorist acts. The resolution strengthened the hand of the Bush Administration as it embarked on its war on terrorism.”¹

Over the past years, US Congress has approved several laws for combating money laundering the most significant of which is the USA PATRIOT Act of 2001 that was followed by a broad Executive Order No. 13244, issued by President George W. Bush on September 24, 2001, “blocking the assets of, and prohibiting transactions with, a number of persons and entities believed to be terrorists or fronts, including Osama bin Laden and Al Qaeda organization.”² The order set the stage for a worldwide noose the United States threatens to tighten around nations and financial institutions that harbor or support what the US deems to be terrorist financing. Included in this threat are closing the door to US financial markets and dollar clearance facilities and seizure of accounts of foreign financial institutions, including their correspondent accounts at US banks.

The G-7 followed suit when, on September 25, 2002, they declared that they would also “block the assets of terrorists and their associates and pursue a

¹ Baroudi, Sami E. (2005). U.S.-Lebanese Relations in the 21st Century: A View from Beirut. *The Arab World Geographer* (Vol. 8, No. 4, pp. 201.)

² Zagaris, Bruce. The merging of the counter-terrorism and anti-money laundering regimes, *Law and Policy in International Business* (Fall 2002).

comprehensive strategy to disrupt terrorists.”³ The G-7 also called on the Financial Action Task Force (FATF), at the OECD in Paris, to include terrorist financing into its activities, which it has accomplished by expanding, in October 2001, its mandate to include combating the financing of terrorism and the issuance of the *Eight (later expanded to nine) Special Recommendations on Terrorist Financing*.

Lebanon obliged, and the Central Bank established, by virtue of Law 318 of April 20, 2001 (Fighting Money Laundering), the Special Investigation Commission (SIC) as an independent, legal entity with judicial status. Chaired by the Governor of the Central Bank, “the SIC is the financial intelligence unit of Lebanon mandated to receiving, analyzing, and disseminating disclosures of operations suspected of concealing money laundering, and monitoring compliance with the regulations and procedures stipulated by the Law 318 (Article 6/1), as well as the lifting of banking secrecy provisions (Banking Secrecy Law of 1956) to the benefit of competent judicial authorities and the Higher Banking Commission.”⁴

Under the provisions of Law 318 (Article 1/3), terrorist acts are to be understood as “specified in Articles 314, 315 and 316 of the Lebanese Criminal Code as well as to finance or to contribute to the financing of terrorism, terrorist acts, or terrorist organizations, according to the concept of terrorism in the Lebanese Penal Code.”⁵ Still, Lebanon should consider joining the U.N. Convention for the Suppression of the Financing of Terrorism (1999) and for the Ministry of Justice to review certain provisions of the Penal Code.

³ “G7/G8 Counter-terrorism cooperation since September 11th backgrounder,” www.g8.fr/...2002/g8_counter-terrorism

⁴ “AML/CFT Laws & Regulations,” Special Investigation Commission 2010 Annual Report Section III, pp. 57-58, http://www.sic.gov.lb/downloads/Eng_SIC_2007.pdf

⁵ Ibid.

1.2 Research Question, Relevance of the Study, and Methodology

This subsection shows the significance of the research question and methodology undertaken to the field of international relations in an ever more interdependent world economy. The new war on terrorism that started with the 9/11 terrorist attacks on US soil has led to a tsunami of successive Governments' regulations and anti-measures including sanctions against terrorists and state-sponsors of terrorism. Furthermore, the methodology used will focus on analyzing the theoretical framework of laws and by-laws and international regimes that structure combating the financing of terrorism and money laundering counter-measures.

While Lebanon strives to maintain the banking secrecy law, it is being urged to address international pressures regarding money-laundering and the financing of terrorism. The banking secrecy law states that "it is an offense for any bank employee, including top management, to reveal their knowledge of clients' names, assets, or holdings to any individual, even those in authority, without the written authorization of the client."⁶

With this and other related changes in the way the financial system is addressing change in international context, this thesis will seek to answer the following question: *How has Lebanon sustained its leading role as one of the most important financial and banking centers in the region based on its longstanding banking secrecy practices as well as complied with the anti-money laundering and combating the financing of terrorism international standards?*

The significance of the research undertaken stems from the novelty of such a study which, to my knowledge, seems lacking and has yet to be addressed in the

⁶ Barazy, Ma'an, "The Lender of First Resort: An Anatomy of Resilience," (Data Invest Arabia INC, Policy and Research Papers; 1st ed. June 2009): p.49-51.

political science literature? The importance of the research question also stems from the need to explore the ramifications of twenty-first century security (terrorist) threats and to highlight the potential for conflict between international (mainly U.S.) pressures and domestic politics that is a direct result of globalization. Furthermore, the topic is of current interest amidst raising international anti-terrorism sentiments. Arguably at the lead of these changes is the US, which is exercising its power through use of stick and carrot policies to compel target states to change their behavior. This research aims to contribute to the field of study by examining the extent to which the financing of terrorism is being discussed in the security context and the influence of non-state actors' threats on foreign policy formation.

The methodology used in the thesis is the case study model, where it will focus on analyzing the framework which makes use of international and domestic levels of analysis. According to Waltz, "if the international system level is the focus, then the explanation rests with the anarchic characteristics of that system or with international and regional organizations and their strengths and weaknesses. If the domestic level is the focus, then the explanation is derived from characteristics of the state: the type of government, the type of economic system, interest groups within the country, or even the national interest."⁷

The significance of levels of analysis in the study of international relations was further discussed by Singer who argued that "one's choice of a particular level of analysis determines what one will and will not see since different levels tend to emphasize different actors and processes."⁸

⁷ Waltz, Kenneth N., *Man, the State, and War* (New York: Columbia University Press, 1954); and Singer, David J., "The Levels of Analysis Problem," *International Politics and Foreign Policy*, ed. Rosenau, James N., (Rev. ed.; New York: Free Press, 1961), 20-29.

⁸ Singer, David J., "The Level-of-Analysis Problem in International Relations," in *International Politics and Foreign Policy*, ed. Rosenau, James N., (New York: Free Press, 1969), pp. 20-29.

International relations theorists tend to be interested in patterns of behavior among various international actors for which modest predictions about the possible nature and direction of change can be made. In this thesis three alternative images or perspectives of international relations are emphasized and labeled: realism, pluralism, and globalism. It is argued that these images or divisions have provided the basis for the development of many theoretical works that attempt to explain various aspects of international relations.

For realists, states represent the key unit of analysis in the international system; hence, any study of the latter will involve the study of relations among these units. As for non-state actors, international organizations such as the United Nations (though this is more accurately described as an inter-governmental organization), multi-national corporations, terrorist groups, and other transnational organizations are of less importance. The state, as a unitary actor – having one policy at any given time on any particular subject, is fundamentally a rational decision-making unit evaluating available alternatives and making preferences maximizing benefit or minimizing cost connected with achieving the objectives required. Power is a key concept to the realists who view national security and strategic issues as high politics, whereas economic and social issues are viewed as low politics.

The pluralist or liberal view deems non-state actors important and independent entities in their own right. For liberals, state decisions result from bureaucracies, interest groups, and individuals are tied by competition, coalition building, conflict, and compromise among these actors. Hence, attempting to reach a consensus or at least a minimum pleasing partnership is a procedure far different in kind from the realists' account of state as a rational actor. Finally, economic and social issues are constantly at the forefront of the liberal agenda of international politics.

The third perspective, globalism deems the global environment within which states and other entities interact as the starting point of analysis. To understand the external behavior of states requires examining domestic factors and the structure of the system that conditions and influences states and non-state actors to act as mechanisms of domination in a world capitalist system by which some manage to benefit at the expense of others. Globalists believe that economics is central to understanding the creation, evolution, and functioning of the contemporary world system. In particular, they are typically concerned with the development and maintenance of dependency relations among North-South states.

The theoretical framework of the thesis will include the international system (distribution of power among states, geography, technology, and other factors) on one hand and the state (often treated as a unified actor) and society or regime (democratic, authoritarian, etc.) on the other hand. It is also quite typical for these levels to be used to “explain the foreign policy behavior of states – the dependent variable. The state, in other words, is often the unit of analysis, and explaining its behavior could entail taking into account factors at different levels of analysis.”⁹

1.3 Theoretical Framework

The concept of interdependence is discussed by the proponents of all three images of international relations, but the pluralists take it to heart because it captures much of the essence of their view of world politics. Interdependence is to pluralists what balance of power is to realists and what dependency is to globalists. Interdependence specifies that two or more units are dependent on one another. While pluralists have argued that the term provides a simpler and more accurate explanation

⁹ Viotti, Paul R. and Kauppi, Mark V. “*International Relations Theory: Realism, Pluralism, Globalism, and Beyond*,” (3rd ed.; Longman Publishers; 1999), pp. 13-16.

of the current nature of world politics than does the concept of balance of power, realists tend to see interdependence as the vulnerability of one state to another, a view that suggests that it is to be avoided or at least minimized.

Keohane and Nye determined that “interdependence involves reciprocal effects among countries or among actors in different countries. Although there are costs associated with interdependence, defined as sensitivity, benefits to either or both parties may outweigh these costs.”¹⁰ Pluralists focus on the multiple channels linking societies, including inter-state, trans-governmental, and trans-national relations. Somehow, there is a “decided absence of hierarchy among issues such that socioeconomic issues may be as or more important than security issues. Moreover, when such complex interdependence exists, military force tends to have less utility in the resolution of conflicts.”¹¹

Managing interdependent relations may even involve construction of sets of rules, procedures, and associated institutions or international organizations to govern interactions in these issue areas – so-called international regimes. Consistent with this understanding, Krasner defines regimes as “implicit or explicit principles, norms, rules, and decision-making procedures around which actors’ expectations converge in a given area of international relations.”¹²

As such, international regimes are not the same as international organizations – they do not have a mailing address. They are constructs defined by observers – an analytical concept. Regimes may accompany an organization, but the former do not have the capacity to act. Furthermore, an international organization associated with a

¹⁰ Keohane, Robert O. and Nye, Joseph S., “*Power and Interdependence*” (Boston: Little, Brown and Company, 1977), p.8.

¹¹ See Keohane and Nye, *Power and Interdependence*, p. 24-29.

¹² Stephen Krasner, “*Structural Causes and Regime Consequences: Regimes as Intervening Variables,*” in *International Regimes*, ed. Stephen Krasner (Ithaca: Cornell University Press, 1983), p. 2.

particular regime may concern itself with more than one regime or issue area – the United Nations, for example.

Three main parts make up for the foundation of the analysis. The first provides an extensive literature review and theoretical context that will entail a comprehensive analysis of the characteristics and features of terrorism and US foreign policy. The second part focuses on the analysis of the policy outputs of the Financial Action Task Force Recommendations on anti-money laundering and combating the financing of terrorism. It shows how the FATF was set about and how its mandate was expanded throughout the years to include special recommendations on combating the financing of terrorism and its tool of naming and shaming to monitor compliance with the recommendations. The third part focuses on the discourse analysis of the assessment of Lebanon's AML/CFT regime that was conducted by the Middle East and North Africa Financial Action Task Force. It involves a discussion of the report that was issued by the MENAFATF and provides insight on what is needed for the future.

The overall time frame for the thesis is from the mid-1980s underlying the terrorist attacks of September 11, 2001 to the present day. Although there is a long history of terrorism, 9/11 marks the intensification of terrorist attacks or perceived threats from non-state actors on western soil revealing the environment of new security challenges including global money laundering and terrorist financing.

1.4 Plan of the Thesis

This thesis is divided into six chapters, including an introduction and a conclusion. The introduction lays out the topic and highlights why it is important. In addition, it places the topic in a theoretical framework that emphasizes the potential for conflict between domestic Lebanese political (and other) pressures and international pressures that is a direct result of globalization. As previously noted, this

conflict is further highlighted by the nature of the topic at hand: money laundering and terrorist financing, which themselves have seen major growth owing to globalization. Lastly, the chapter tackles the methodology used to answer the thesis question.

Chapter two provides a thorough overview on what the Financial Action Task Force is and how it works. It describes how the FATF mandate has expanded over the years helped by an ever-growing consensus on the dangers money laundering and terrorist financing represent. It examines how the FATF recommendations and their implementation have become the core of FATF's effort to preserve the integrity of the financial system. It also explains the sophisticated tools the FATF has honed over the years to monitor compliance with the recommendations, including its procedure for following up on shortcomings and publicly identifying high-risk and non-cooperative jurisdictions having persistent strategic weaknesses.

Chapter three focuses on US money laundering laws and lays the groundwork for how these have impacted the international standards and ultimately similar laws and policies in Lebanon. On October 26, 2001, President George W. Bush signed the most far-reaching law enacted in the United States since the New Deal legislation of Franklin Roosevelt's time. The USA Patriot Act of 2001 bolsters the potency of the money laundering laws and Bank Secrecy Act to levels unseen since they were enacted in 1986 and 1970 respectively. Encouraged by the strong congressional desire to close the avenues of terrorist financing, the laws now reach levels of coverage and scope that would not have been possible had it not been for the events of 9/11.

Chapter four demonstrates how the efforts that have been exerted recently to build up anti-money laundering and combating the financing of terrorism regimes bring together multipurpose yet interrelated aspects of financial systems and criminal

law. In this regard, Financial Intelligence Units (FIUs) make up for an essential component of these regimes through which critical information on suspicious accounts is made available to various but complementary law-enforcement agencies allowing them to trace illicit proceeds of crimes regardless of the banking secrecy policies.

Chapter five provide a summarized account on the eminent role of the Central Bank of Lebanon, above all its anti-money laundering and combating the financing of terrorism regime's assessment that was conducted by the MENAFATF in November 2009. It further elucidates and analyses Lebanon's money laundering and financing of terrorism counter-measures, assesses its compliance with the FATF recommendations and presents the suggested action plan to improve the AML/CFT regime.

The concluding chapter seeks to summarize various discussions in the thesis and provides an answer to the central research question: Can Lebanon sustain its leading role as one of the most important financial and banking centers in the region based on its longstanding banking secrecy practices as well as comply with international pressures regarding anti-money laundering and combating the financing of terrorism international standards?

1.5 Challenges to Answering the Research Question

Unprecedented developments in world politics since the end of the Cold War have led to a growing number of other concerns emerging at the forefront of the international political agenda which demonstrate the complexity and interdependence of world politics. Since the methodology used in this research is the case study model, where the thesis examines the potential for conflict between domestic Lebanese political pressures and international pressures that is further highlighted by the nature of the topic at hand: money laundering and financing of terrorism which have seen

significant growth due to globalization; this study suffers from being too wide on a multiple issue areas and hence being unable to provide a simple answer to the question raised. This challenge is a source of on-going debate in the social sciences, and proponents of the case study model have been so far able to demonstrate the capability of their model to highlight and produce some really helpful theories and lessons. Another limitation that thwarts this work, due to the constricting perimeters of the MA thesis, will be the absence of personal interviews and field research which would have added some new and useful data to the study. Consequently, this thesis relies on the available literature. The literature on international regimes implicitly suggests that a regime must have a single issue that it seeks to regulate. The concept of an issue, however, suffers from lack of clarification in current International Relations literature. This thesis will show that the terrorism phenomenon is too multi-faceted and multi-dimensional to be viewed as a single issue, as an analysis of the values and the stakes evoked will demonstrate.

Robert Litan, an economist at the Brookings Institution in Washington, describes regional and international financial contagions as “a direct consequence of a process of globalization that has also facilitated the transmission of financial crises across national borders.”¹³ The financial crisis of 2008, globally labeled the most horrific economic crisis since the Great Depression of the last century, has broadly harmed the international financial system, many individuals, local communities, non-financial businesses and national and international interests that rely upon that system.

Money laundering and terrorist financing were not the cause of that mischief; for there is no evidence to suggest that both have changed as a consequence of the crisis in any significant way to the changes in behavior of honest citizens. Yet it is

¹³ Litan, Robert E. “Economics: Global Finance,” in *Managing Global Issues* (Washington, DC: Carnegie Endowment for International Peace, 2001).

more probable that “the policy responses to the crisis are likely to benefit the global AML/CFT efforts by improving transparency and ensuring more rigorous assurance procedures in the financial system.”¹⁴

In the context of the international financial system, it is useful to distinguish between the transparency and accountability of three groups of participants: the private sector, national authorities, and international financial institutions. “The decisions made by any one of these groups are affected by the decisions, or anticipated decisions, of the other two. And there is plenty of room for significant improvement in the transparency and accountability of these groups.”¹⁵

Moreover, Seiichi Kondo, Deputy Secretary General of the OECD, in the opening speech at the High Level Consultations on OECD Harmful Tax Competition on January 8, 2001, stated that “globalization can pose problems, not just for individuals, but for governments as well. New opportunities are opened up for individuals and enterprises to engage in illegal activities, such as hard core cartels, bribery, money laundering and tax abuses, which distort trade and investment. . . . We must urgently address this dark side of globalization if we are to maintain broad political support for open markets and for the benefits that these can bring in terms of greater freedom and choice for citizens and enterprises worldwide.”¹⁶

Meanwhile, over US concerns that Syria, Iran and Hezbollah are using Lebanon’s financial system to evade international sanctions and fund their activities, the Obama administration has intensified its scrutiny of Lebanon’s banking sector. The Treasury Department has pressed the Central Bank to more closely monitor local

¹⁴ FATF/OECD, 2010 Global Money Laundering & Terrorist Financing Threat Assessment: A view of how and why criminals and terrorists abuse finances, the effect of this abuse and the steps to mitigate these threats. www.fatf-gafi.org

¹⁵ “Report of the Working Group on Transparency and Accountability,” International Monetary Fund, (Washington, DC: World Bank Group, October 1998).

¹⁶ “High Level Consultations on Organization of Economic Cooperation and Development Harmful Tax Competition,” OECD, 8 January 2001, <http://www1.oecd.org/media/speeches.htm#kondo>

banks that have operations in Damascus and Tehran. US officials have also expressed concerns over Hezbollah's close military alliance with Syria and Iran and their control of the government. Riyad Salameh, Governor of the Central Bank, exclaimed that the

“Government has stepped up its efforts over the past year to combat money laundering through Beirut,”¹⁷ and that “deposits by Syrian nationals in Lebanese banks, both inside Syria and Lebanon, as well as loans granted to Syrians by these banks, have decreased by 40% over the past 15 months, without citing the dollar figures.”¹⁸

Pundits contend that “terrorism is clearly one response to globalization.”¹⁹ The shocking events of September 11, 2001 created an abrupt awareness of terrorists' presence, their organizational capabilities, their multinational composition, the extent of their malice, and their ongoing capacity to produce enormous, and possibly unrivaled, harm. Formed into relatively small but cohesive units, terrorist groups have demonstrated that they possess both the means and the will to act. Their deep-seated purpose is to obtain publicity for their cause and to acquire cohorts for future activities. The proliferation of home-grown terrorists has resulted from local conditions. The successes of the Al-Qaeda have been a source of inspiration. Local leaders have had the responsibility for building their own infrastructures. The local successes, and there have been many, in Asia, Europe, the US, and in November 2002 in Kenya, and in May 2003 in Saudi Arabia, have been the product of a decentralized approach. It is evident that these successes have, on the whole, been in democratically oriented countries; not in totalitarian states.

¹⁷ *The Daily Star*, “Salameh: Banking sector abides by law,” July 10, 2012.

¹⁸ *Ibid.*

¹⁹ Terrorism, in the sense of intentional harms to civilians, is not a modern phenomenon. C. Carr, *The Lessons of Terror: A History of Warfare against Civilians* (2002). A general reference is the Department of State publication, *Patterns of Global Terrorism*.

1.6 Terrorism

Terrorism is a particular kind of asymmetric warfare that has increasingly become a major international security threat. Terrorist attacks against an adversary's population, such as those carried out by Al-Qaeda against US embassies in Africa in 1998, against cities on US soil in 2001, the bombing of the Madrid rail station in 2004, and the London subway attack in 2005 have ushered in a new era of terrorism. Scholars have emphasized the changing nature of terrorism in the 1990s and its global reach and adaptive nature. Terrorism engages "four main elements: (1) premeditation, the decision by a perpetrator to commit an act to instill terror or fear in others; (2) motivation or a cause, whether it is political, religious, or economic; (3) targets, usually noncombatants, such as political figures, bureaucrats, or innocent bystanders; and (4) secrecy, where perpetrators belong to clandestine groups or are secretly sponsored by states."²⁰

"Terrorism has a lengthy record, starting in Greek and Roman times; terrorist acts were often carried out by individuals against a ruler. In the Middle Ages, factions perpetuated violence against other factions, while during the French Revolution, acts of terrorism were sponsored by the state itself. Organized state terrorism used against a state's own citizens reached its climax in Nazi Germany and the Soviet Union under Joseph Stalin. Terrorists began to use aircraft hijackings in the 1970s to communicate their message. For example, in December 1973, Arab terrorists killed thirty-two people in Rome's airport during an attack on a US aircraft. Hostages were taken in support of the hijackers' demand for the release of imprisoned Palestinians. In 1976, a French plane with mostly Israeli passengers was hijacked by a Middle Eastern organization and flown to Uganda, where the hijackers threatened to kill the hostages unless Arab prisoners in Israel were released."²¹

Much of the current terrorist activities have their roots in the Middle East – in the Palestinians' quest for self-determination and their own internal conflicts over strategy, in the hostility among various Islamic groups toward Western powers, and in

²⁰ Pillar, Paul R., *"Terrorism and U.S. Foreign Policy,"* (Washington, D.C.: Brookings Institution Press, 2001), pp. 13-14.

²¹ Mingst, Karen A. *Essentials of International Relations* (New York: W.W. Norton & Company, Inc., 2008, 4th ed.), pp. 225-229.

the resurgence of Islamic fundamentalism. Among the groups with roots in the Middle East are Hamas, Hezbollah, and Palestine Islamic Jihad. Since September 11, 2001, Al-Qaeda organization has been the most publicized. A shadowy network of Islamic fundamentalism from several countries, including countries outside of the Middle East, Al-Qaeda led by Osama bin Laden, is motivated by its desire to install Islamic regimes in the Middle East, support Islamic insurgencies in Southeast Asia, and punish the United States for its support of Israel and for its close ties with corrupt regimes in the Middle East.

“Highlighting the changing nature of terrorism in the 1990s, scholars emphasize its global reach and adaptive nature. There are three key features to the contemporary terrorist threat. First, there is evidence of a more global character with a majority of the attacks being carried out by associated cells with roots in the Middle East, Africa, and the Caucasus. Second, terrorist attacks have increased since 9/11 and this drastic increase in terrorist threat has been a result of Al-Qaeda’s transformation from a group into a movement. Lastly, there is significant evidence that Al-Qaeda and other terrorist organizations have adapted their structure significantly.”²²

Since the 1990s, terrorism has taken a new turn. The acts have become more dangerous, “almost one-quarter of terrorist attacks resulted in deaths, compared to 17 percent in the 1970s. Until 2000, the worst loss of life came from the 1985 bombing of an Air India flight in which 329 people were killed. That changed dramatically on September 11, 2001, when over 3000 civilians died and \$80 billion in economic losses were incurred. The choice of weapons used by terrorists has become more diverse. The infrastructure used to support terrorism has also become more sophisticated. It is financed through money laundering schemes and illegal criminal activities.”²³

²² Gardner, Kathryn L., “Fighting Terrorism the FATF Way,” *Global Governance*, July-Sept 2007 Issue see at <http://www.rienner.com/uploads/49933a6177586.pdf>

²³ Caldwell, Dan and Williams Robert E. Jr., *Seeking Security in an Insecure World* (Lanham, Md.: Rowman & Littlefield, 2006); and Walter Enders and Todd Sandler, “Distribution of Transnational Terrorism among Countries by Income Class and Geography after 9/11,” *International Studies Quarterly* 50:2 (June 2006), pp. 367-68.

Responding to terrorism has become increasingly difficult, because most perpetrators have networks of supporters in the resident populations. Protecting populations from random acts of violence is an almost impossible task, given the availability of guns and bombs in the international market-place and the necessity, at least in Western democratic states, of balancing civil and human rights with anti-terrorist legislation.

The international community has taken action against terrorists mainly by creating a framework of international standards dealing with terrorism, including a number of conventions that address such issues as punishing hijackers and those who protect them; protecting airports, diplomats, and nuclear materials in transport; and blocking the flow of financial resources to global terrorist networks. In recognizing the threat posed to the international financial system and to financial institutions, the Financial Action Task Force has been at the forefront of measures to counter attempts to abuse the global financial system to further criminal and terrorist purposes.

Steps have also been taken by individual states to increase state security, such as in the United States through the passage of the controversial USA PATRIOT Act; to support counter-intelligence activities; and to promote cooperation among national enforcement agencies in tracking and apprehending terrorists. Countries that have been seen as supporting terrorists, or not taking effective counter-measures, have been sanctioned by other states. Libya, Sudan, Afghanistan, Syria, Iran, and Iraq are prominent examples of targeted sanctioning by the US Government.

Control over the financial resources of terrorists can play a critical role. To this end, the United States, many foreign states, and the United Nations, as well as a host of other international organizations can impose certain limitations to prevent the movement of funds across national borders for the benefit of resident terrorists. The

thesis now turns to the next chapter to argue how the Financial Action Task Force international standards that was, originally, meant for combating money laundering has expanded over the years to cover financing of terrorism counter-measures.

CHAPTER TWO

THE FATF SOFT-LAW: BUILDING CONSENSUS

2.1 Introduction

This chapter provides a thorough overview of what the Financial Action Task Force (FATF) is and how its mandate has expanded over the years helped by an ever-growing consensus on the threats money laundering and financing of terrorism represent. It shows how the FATF's recommendations and their implementation has become the core of FATF's attempts to maintain the integrity of the financial system. By means of a sophisticated apparatus that the FATF has perfected over many years, it is largely able to monitor compliance with the Recommendations, including a procedure for following up on deficiencies and openly identifying high-risk and non-cooperative jurisdictions having persistent strategic weaknesses through its naming and shaming mechanism.

Moreover, this chapter provides further insight into the FATF's ability to face up to new or unanticipated developments that may pose a risk to the financial system, and examines the extent to which the FATF Special Recommendations on combating the financing of terrorism and UN Security Council Resolutions 1267 and 1373 have been implemented and the difficulties in applying international law instruments where measures are aimed at non-state actors and assets as well as ensuring that individuals affected by these measures have adequate legal recourses.

2.2 Money Laundering and Terrorist Financing Threats

Although they differ on purpose, money laundering and terrorist financing share a common infrastructure—the international financial system—to realize their

non-benign objectives: the former for the profit motive the latter to make a political statement. The success of the FATF makes it an ideal candidate for combating terrorist financing. An effective counter-terrorist financing strategy must reflect the adaptive and global nature of terrorist groups. Some of the challenges facing states in combating terrorist financing are assessing threats and understanding terrorists' behavior with the aim for establishing and implementing an effective global response that requires coordination points, flexibility, and states' compliance.

As noted earlier, "In the 1990s, a number of issues has ushered in a new age of terrorism evident more than ever in the Al-Qaeda network. First, the global nature of terrorist attacks being carried out by groups associated with Al-Qaeda. Second, the major inflate of terrorist threat has been a result of Al-Qaeda's alteration from a faction into a movement and, third the fact that Al-Qaeda and other terrorist groups have successfully customized their structures."²⁴

Therefore, in view of an ever changing global threat, an equally dynamic counter-terrorist financing strategy is vital. This has been sought by the UN request that states increase dynamism and compliance. In Resolution 1617, the Security Council "asserts that the standard-setting, coordinating, and capacity-building efforts of the FATF embody the mechanism for counter-terrorist financing."²⁵ The FATF's Typologies Exercises, Best Practices, and Guidance have supported implementation of relevant UN resolutions and provided an annual forum for countries for exploring terrorist financing methods.

The FATF's counter-terrorist financing strategy has faced three central challenges: solid denial of assets, knowledge of terrorist threats, and vigorous state compliance. Accessible political and financial systems are vital to terrorist support

²⁴ Gardner, Kathryn L., "Fighting Terrorism the FATF Way," *Global Governance*, July-Sept 2007

Issue see at <http://www.rienner.com/uploads/49933a6177586.pdf>

²⁵ Ibid.

and activities, thus requiring a counter-terrorist strategy that dismantles the enabling environment of terrorism, with the real denial of assets taking priority. The international community has become more sensitive to the primary role of financing in global terrorism. Thus, by following the money, the task of preventing a future terrorist attack has focused on disrupting financing channels of transnational terrorism.

Money laundering, the technique by which proof of money's illicit origins has been obscured or separated through multiple, layered transactions in the financial system, is hypothetically and empirically tied to contemporary terrorist activity. As such, “the goal is to conceal or hide the tainted ownership of the money and provide legitimacy for it. In each case, the troubles have both domestic and transnational aspects.”²⁶

Unlike money laundering, terrorist financing generally involves financial resources originating from legitimate businesses to support illegitimate activities, rather than the reverse, setting up a major impediment in tracing the money. Moreover, conventional money laundering involves a profit motive while, usually, terrorist financing has (largely) non-economic motives. A last dissimilarity is in their scope. Traditional money launderers deal with large cash deposits while terrorists deal with substantially lesser amounts of money which makes detecting terrorist financing a more difficult task, leading to criticism that tracking the money is a marginal strategy in countering terrorism.

While the final figures of blocked and seized assets are certainly a success, a UN report on sanctions to block Al-Qaeda funds asserts that “the point isn’t grabbing dollars in bank accounts... It is destroying the financial infrastructure of terrorism.

²⁶ Ibid.

That means seizing money, but it also involves dismantling the channels of funding, deterring those who would give aid and support to terrorists, and following the leads to terrorist cells.”²⁷

Despite the differences between money laundering and terrorist financing, the similarities allow countries to utilize the same techniques and mechanisms developed nationally and internationally to counter each. International tools such as Customer Due Diligence and Suspicious Transaction Reports can be of great use as investigative devices to determine not only the source of funds but also their destination. Moreover, international cooperation mechanisms are situated for the exchange of information, blocking funds, and shutting down channels used to transfer funds. In order to evade these obstacles, “terrorists utilize techniques that are non-transparent; sometimes they use legitimate systems with illicit merchandise or illegitimate systems such as trade-based money laundering.”²⁸

In constantly adapting to changes in the global environment, terrorists relentlessly prey upon the least developed financial systems as well as utilizing the financial infra-structure of developed ones. As noted before, “understanding the factors that induce and condition compliance with counter-terrorist global standards is significant to the effectiveness of the international endeavor. States are fundamental in the compliance process. In particular, compliance is a function of a state’s capability.”²⁹

A lack of effectual state power is a window of vulnerability for the state, creating conditions where violence and illicit activities, such as money laundering and terrorist financing, thrive. Weak states or low-capacity states face difficulties in complying, while some states, regardless of strength, are averse to comply. A state’s

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.

intent to comply is the pillar for compliance and there is no substitute for the engagement of self-interest. Compliance is a consequential choice made by rational actors who reflect a claim that the costs of violation outweigh its benefits.

Full and efficient roll-out of counter-terrorist standards in all countries is one of the fundamental tasks of the FATF, who, as an inter-governmental body, has produced a *Guidance on Capacity Building for Mutual Evaluations and Implementation of the FATF Standards within Low-Capacity Countries*. The document identifies some principles and specific mechanisms and procedures that may be used by low-capacity countries to attain successful prioritization and implementation of FATF standards.

2.3 The Impact of the International Political Economy

For Stephen Krasner, the “international political economy (IPE) is concerned with the political determinants of international economic relations.”³⁰ IPE tackles questions such as: How have changes in the international distribution of power among states affected the degree of openness in the international trading system? Do the domestic political structures and values of some states allow them to compete more effectively? When can international economic ties among states be used for political leverage?

Going further, IPE has been dominated by four major perspectives – liberalism, realism, domestic politics, and Marxism. Only the first three will be discussed in this chapter. However, “the central debate in IPE has been between liberal and realist analysts. The first has focused on the incentives and opportunities for cooperation; while the latter has focused on how power has influenced both the

³⁰ Krasner, Stephen “The Accomplishments of International Political Economy.” *International Relations Theory: Realism, Pluralism, and Beyond* (MA: Allyn and Bacon, 1999): pp. 184-196.

character of international regimes and conflicts among nations.”³¹ Krasner goes on to claim that “explanations which emphasize the interaction between domestic and international politics, the way in which domestic structures, values and groups influence international relations and vice versa have, in some specific cases, been deeply illuminating, but no one has presented a coherent general theory.”³²

The explanatory variable for liberalism is the configuration of interests and capabilities associated with a given issue area; that is, outcomes, including the creating of institutions designed to secure Pareto optimal outcomes (situations in which no actor can be made better off without making some other actor worse off), are a function of the preferences and capabilities of a variety of different actors concerned with maximizing their own individual utility.

The evidence that is needed for a liberal analysis involves specifying the relevant actors (states, multinationals, etc.), assessing their resources and signifying their objectives (including not only their interests but also the constraints and incentives that are presented by existing institutional structures and other actors).

Every theoretical perspective works with an exemplary problem which is assumed to be the most important kind of issue in the international system and which can be analyzed using the theoretical tools (assumptions, evidence and causal arguments) of that approach. The exemplary problem for contemporary liberal analysis is market failure; that is, situations in which the purely individual calculations of interest do not lead to Pareto optimal outcomes.

Liberalism offers a basically benign image of the global economy. There are many different actors with varying interests yet opportunities exist for cutting deals

³¹ Ibid.

³² Ibid.

where everyone can be better off at the same time. Human ingenuity and intelligence can create new institutions that encourage behavior that leads to Pareto optimal ends.

“The liberal cooperation theory analyses market failure problems where states may fail to maximize their own utility because individual self-interested behavior results, in some cases, such as a prisoner’s dilemma payoff structure or the provision of collective goods, in a Pareto suboptimal outcome. These failures can often be resolved by the creation of institutional arrangements that provide information, monitoring and salient solutions. Cooperation theory relies on analytic techniques, mainly game theory and rational choice which are heuristically very potent in probing various issues related to trade, finance, the environment and economic sanctions.”³³

The explanatory variable for realism is the distribution of power among states. The basic claim of realism is that given a particular distribution of power among states it is possible to explain both the characteristics of the system and the behavior of individual states. Realism makes no effort to probe the domestic determinants of foreign policy; what counts is state power and external constraints.

The evidence that realists utilize requires operationalizing the power of states by; for instance, looking at the size of armies, aggregate economic output, or the ability to make credible threats.

While Waltz claims that the explanatory problem for realism is “to explain how zero sum or distributional conflicts are resolved given the power and interests of states,”³⁴ Krasner, approvingly, notes that “the world is a hazardous place where economic transactions among states can, in some circumstances, be used for political leverage. States exert great efforts to define international regimes because different regimes have different distributional consequences.”³⁵

³³ Keohane, Robert O. *After Hegemony* (Princeton: Princeton University Press, 1984); Stein, Arthur, *Why Nations Cooperate: Circumstance and Choice in International Relations* (Ithaca: Cornell University Press, 1990).

³⁴ Waltz, Kenneth, “*Theory of International Politics*,” (Reading, MA: Addison Wesley, 1979).

³⁵ Krasner, Stephen, “Global Communications and National Power: Life on the Pareto Frontier”, *World Politics*, 43, (1991): pp. 336-67.

Realist analyses of international political economy have addressed two kinds of issues: first, how national power has influenced relations among specific countries; and second, how the distribution of power in the system as a whole has determined international regimes. One basic expectation of realist analyses is that there will be tension, although not necessarily war, among the major states in the international system regardless of their domestic political structures.

Albert Hirschman's *National Power and the Structure of Foreign Trade* (1945) remains one of the most illuminating discussions of the way in which power affects international economic relations among specific countries. He argues that

“there are two ways in which trading relations could be used to alter the capabilities or policies of another state: first, states could limit the availability of critical products or technology in an effort to weaken the resource base of their opponents; second, one state could attempt to change the foreign policy behavior of another by threatening to change the rules of the game governing their economic transactions.”³⁶

The second major emphasis of realism has been the relationship between the distribution of power among states in the international system and the nature of international economic regimes. The most prominent argument along these lines is the realist version of hegemonic stability theory which asserts that “a stable open international economic system is most likely when there is a hegemonic distribution of power; that is, when there is one state that is much larger than any of the others.”³⁷ There is also a liberal version of hegemonic stability theory which calls for “the need for a hegemonic state to provide collective goods, especially acting as a leader of last resort in the financial sector.”³⁸

³⁶ Krasner, Stephen “The Accomplishments of International Political Economy,” *International Relations Theory: Realism, Pluralism, and Beyond* (MA: Allyn and Bacon, 1999), pp. 184-196.

³⁷ Littlefield, Alex, “Exploring the Security Dimension of Sino-US Trade Asymmetry (Implications of the International Trade System). See at <http://www.au.af.mil/au/ssq/2010/spring/littlefield.pdf>

³⁸ Ibid.

The last theoretical focus of IPE has been the relationship between domestic politics and the international system. There have been two general lines of inquiry. The first is that there is no dominant argument about the influence of the international system on domestic political structures. The second line of argument points to the influence of domestic factors such as interest groups, values and ideas. International economic policy, like any other policy, can be explained by the pattern of domestic pressures. Internationally competitive industries and factors will opt for openness; import competing industries will favor closure.

While the United States remains the only global power, its capabilities in many important issue areas have deteriorated, suggesting that it will adopt a more narrowly self-interested policy. The United States will be less concerned about keeping with international economic rules that are not optimal for it, even if such rules would provide greater benefits for the system as a whole. In the late, 1990s, Washington found itself regularly alone and on the other side of such issues as the Antiballistic Missile Treaty, the Comprehensive Nuclear Test Ban Treaty, the Land Mine Convention, the Kyoto Climate Protocol, or the International Criminal Court.

From a realist perspective, Josef Joffe argues that

“the charges of arrogant unilateralism levied against George W. Bush miss the other half of the target; for the roots of Bushist unilateralism reach back to his predecessor’s era. The Clintonites signed on to the Kyoto Climate Protocol in 1997, but let the years pass without submitting the treaty to the Senate. The administration did not accede to the Land Mine Ban, on the sound calculation that it needed land mines to protect its far-flung forces around the world, especially along the demilitarized zone between the two Koreas. After lengthy foot-dragging, Clinton signed up for the International Criminal Court in the last days of his administration, but he did not submit the treaty to an unwilling Senate. Prudence was the better part of goodness, given the unpleasant prospect that a country most likely to be embroiled in violence beyond its borders would also be most likely to expose its soldiers to international prosecution.”³⁹

³⁹ Joffe, Josef, *Overpower: The Imperial Temptation of America*, (W.W. Norton & Company, Inc., New York 2006), pp. 41-42.

By the same token, Charles Krauthammer, one of the most articulate spokesmen of the neoconservative faith, which enjoyed a longish ascendancy in the inner sanctum of American power, claims that “in place of realism or liberal internationalism, the last four-and-a-half years have seen an unashamed assertion and deployment of American power, a resort to unilateralism when necessary, and a willingness to preempt threats before they emerge. Most importantly, the second Bush administration has explicitly declared the spread of freedom to be the central principle of American policy... [T]he president offered its most succinct formulation: the defense of freedom requires the advance of freedom.”⁴⁰

“Now, the United States is alone in the world,”⁴¹ mused the dean of the realist school of international politics, Kenneth N. Waltz, in 2000, and realist “theory predicts that balances disrupted will one day be restored.”⁴² Why so? Waltz believed “As nature abhors a vacuum, so international politics abhors unbalanced power.”⁴³ Hence, “some states try to increase their own strength or they ally with others to bring the international distribution of power into balance.”⁴⁴ Such are the age-old dynamics of the state system.

2.4 The Impact of Global Governance

Global governance means that through various structures and processes, actors can coordinate their interests and needs although there is no unifying political authority. Acknowledgment of globalizing issues and their attributes has led some scholars and pundits to conclude that governance processes need to be conceptualized differently than they have been in the past. The processes of interaction among the

⁴⁰ “The Neoconservative Convergence,” *Commentary*, July-August 2005, p. 22.

⁴¹ “Structural Realism after the Cold War,” *International Security*, Summer 2000, pp. 27-28.

⁴² Waltz, Kenneth N., *Theory of International Politics* (Reading, Mass.: Addison-Wesley, 1979).

⁴³ *Ibid.*

⁴⁴ *Ibid.*

various actors in international politics are now more frequent and intense, ranging from conventional ad hoc cooperation and formal organizational collaboration to non-governmental and network collaboration. These changes have led some to think of there being different components of global governance.

A global civil society is essential for the international relations puzzle to be whole and complete. Political scientist Ronnie Lipschutz claims that “while global civil society must interact with states, the code of global civil society denies the primacy of states or their sovereign rights. This civil society is global not only because of those connections that cross national boundaries and operate within the global, non-territorial region, but also as a result of a growing element of global consciousness in the way the members of global civil society act.”⁴⁵

Several liberals would find this a plausible goal to be attained while many would fear that global governance might undermine democratic values as the focus of governance moves further from individuals, democracy becomes more problematic. For realists, global governance does not exist in anarchy; outcomes are determined by relative power positions rather than law or other regulatory devices.

As Waltz, the quintessential neo-realist, notes that “the anarchic structure of the international system is the core dynamic, Morgenthau acknowledges Waltz’s central thesis, yet he considers there is space for both international law and international organization.”⁴⁶ Radicals are “also skeptical of global governance as a multi-actor, multi-process, decentralized framework, of fear of domination by

⁴⁵ Lipschutz, Ronnie, “Reconstructing World Politics: The Emergence of Global Civil Society,” *Millennium: Journal of International Studies* 21:3 (1992), 398-99.

⁴⁶ Viotti, Paul R. and Kauppi, Mark V., *International Relations Theory: Realism, Pluralism, Globalism, and Beyond*, (New York: Longman Publishers; 1999, 3rd ed.), pp. 13-16.

hegemonic powers who would structure global governance processes to their own advantage.⁴⁷

2.5 The Financial Action Task Force: A Historical Background

In the late 1980s, the problem of illegal narcotics trafficking had become of disturbing level and international worry. Acknowledging the extensive geographical spread of production activities, the global nature of drug distribution routes and drugs' cross-border cash transfers, state legislation and the efforts of law enforcement bodies were no longer adequate. A call for an influential global action to embark upon the global crisis of money laundering and other misuses of the financial system as a way of attacking the heart of illegal narcotics trafficking and organized crime was adamant.

In 1989, the G-7 countries agreed to a number of steps including measures to reinforce international cooperation on eradicating drug supply, including the founding of the Financial Action Task Force. The FATF's objective is to prevent the misuse of the financial system and other institutions for money laundering. More specifically, its mandate is to build up a global consensus on international standards to help identify, track and seize the illicit proceeds from drug trafficking and other crimes.

In 1991-1992 a secretariat was set up for the FATF at the OECD. Although the FATF remains an independent body, the Secretariat is housed administratively at the OECD. In addition, the FATF is not a formal international organization. Rather, it is a task force comprising member governments who agree to its finance on provisional basis with definite objectives and a mandate that was recently approved authorizing the FATF to carry on functioning until 2020.

⁴⁷ Ibid.

The FATF has 34 member jurisdictions and two regional organizations (the Gulf Cooperation Council and the European Commission). There are also 27 international and regional organizations which are Associate Members or Observers of the FATF and participate in its work. The FATF has also encouraged the founding of FATF Style Regional Bodies (FSRBs) to work on its goals starting in the early nineties. In that regard, eight FSRBs were established. Regional organizations provide a regular forum for working relationships among governments and actors at multiple levels.

“Apart from their geographic proximity, the reach and influence of regional organizations depend foremost on their mandates and, secondly, on the resources at their disposal. It is essential to realize that not all regional organizations are created alike. The budgets of FSRBs are smaller than the FATF and, at times, grossly inadequate for the activities to be undertaken. Thus, the organization is only as strong as its member states’ commitment and willingness to fund its institutions.”⁴⁸

2.6 Setting International AML/CFT Standards

In April 1990, the FATF issued its *40 Recommendations on Combating Money Laundering* as a set of international standards intended to identify and prevent money laundering that laid out an extensive set of measures on criminal legal system and law enforcement, financial system and its regulation, and international co-operation. Although non-binding tools under international law, the recommendations alongside other FATF processes and mechanisms, had been proven successful in pressuring all countries to pledge political commitment to implement them with some flexibility in adapting them to their own legal systems and needs. The FATF engaged its members to detect and prevent the misuse of the international financial system by terrorists in response to UN Resolution 1373 and its committee.

⁴⁸ Gardner, Kathryn L., “Fighting Terrorism the FATF Way (Financial Action Task Force),” *Global Governance*, July-Sept 2007 Issue.

The FATF set up a methodology to assess compliance with the recommendations in addition to best practices papers for financial institutions on freezing of assets as well as the development of more specific guidelines for the supervision of non-profit organizations and monitoring of informal value-transfer systems such as the Islamic practice of *Hawala*. The similarity of issues necessitate that compliance with the FATF recommendations would also reverberate compliance with the UN Security Council Resolution 1373 and Counter-Terrorism Committee (CTC) standards. The FATF conducts (Typology Exercises) to identify emerging trends in money laundering and terrorist financing; re-evaluating the significance of its recommendations, and setting new grounds for combating terrorism by altering the environment of terrorist groups and making their present knowledge and capabilities obsolete.

2.7 Monitoring Compliance with AML/CFT Standards

As a policy-setting intergovernmental body, the FATF strives for a broad political will and action necessary to induce national, legislative and regulatory adjustments to combat money laundering and terrorist financing. The center of the FATF strategy is the Know-Your-Customer (KYC) approach that includes: “eliminating anonymous accounts, identifying all customers, maintaining records of transactions for at least five years while making all records available to legal and law enforcement authorities upon request, and notifying proper authorities if unusual or suspicious transactions have transpired.”⁴⁹ The FATF also recommends that states

“Criminalize money laundering, expand the requisite predicate act beyond drug related crimes to other serious crimes, and lower the threshold of reporting to include negligence and willful blindness, as well as to identify, trace, and confiscate laundered money.”⁵⁰

⁴⁹ Ibid.

⁵⁰ Ibid.

The FATF has three mechanisms to assess compliance with the recommendations: the self-assessment routine, the mutual evaluation review and the Non-Cooperative Countries and Territories (NCCT) list. The self-assessment exercises and peer review processes require that each member state submits a report specifying its measures to comply with the recommendations followed by an evaluation process that is usually conducted by a peer government to assess the overall progress of the member state. Monitoring and assessment reviews are fundamental to the FATF's success. As a pre-requisite to membership, FATF members participate in the first two processes, i.e. the annual self-assessment exercises and mutual evaluations. The two processes examine progress by neutrally assessing all countries against the recommendations, identifying deficiencies, and ensuring appropriate consequences for countries and institutions that fail to comply with the recommendations.

In the self-assessment exercise, member countries provide statistical data on the general situation of implementation of the recommendations by means of a standard questionnaire to be completed by each member then analyzed and published by the FATF in its annual report. As noted earlier, "mutual evaluations are the foundation of the assessment process during which, a team of selected experts from legal, financial, and law enforcement fields of FATF member states assesses each country during an on-site examination and issues a report based on its examination. The report provides a comprehensive and objective assessment and highlights those areas in which further progress may still be required. The merits and capacities of states in providing regime-relevant information boost peer reporting, and so enhance the overall effectiveness of the reporting system. Peer review is used not only as a method to emphasize certain deficiencies of a state's AML/CFT regime, but also as a

technique to build capacity through the detection of areas in need of technical assistance.”⁵¹

As soon as a member state is deemed non-compliant, the FATF initiates a four-step counter-measure program that includes: first, “the non-compliant country is required to submit a general report to the FATF plenary meeting. Second, if further measures are required, the FATF president will then send a letter or a high-level mission to the country. Third, the FATF can issue a public statement requiring international financial institutions to pay special attention to transactions from that particular country, its citizens, and businesses. The last measure would be revoking membership status.”⁵² As for non-member states, the FATF employs a (naming and shaming) mechanism making public a NCCT list of countries with serious systemic problems.

2.8 Naming and Shaming

Starting in 2000, the NCCT process was intended to identify major deficiencies in a jurisdiction’s anti-money laundering regime where listed entries would be subjected to counter-measures, such as increased scrutiny by financial institutions. In addition, the NCCT list required that “financial institutions increase scrutiny to individuals, entities, or banks in listed countries or territories with what the FATF has considered inadequate anti-money laundering and counterterrorist financing infrastructure.”⁵³

According to FATF,

“jurisdictions are considered high-risk and non-cooperative when they have adverse regulations and practices in place that impede international cooperation in the global fight against money laundering and terrorism financing. Consequently, the NCCT process intended to reduce exposure of

⁵¹ Ibid.

⁵² Ibid.

⁵³ Ibid.

financial systems by distinguishing countries and territories that fail to comply with the recommendations, to adopt and implement sufficient measures for the prevention, detection and fining of money laundering crime. In that regard, the FATF's counter-measures that have been enacted against NCCTs range from requiring member states to be more alert of NCCT business transactions to prohibiting any financial transactions with NCCTs.”⁵⁴

Hence, from 2000 to 2006, twenty-three jurisdictions were listed due to the lack of an effective AML/CFT regime. The informality of the NCCT tool has allowed for an extra flexible and agile response in all jurisdictions that had been identified as NCCTs in 2000 and 2001 with significant progress. The last jurisdiction was de-listed in October 2006. There is no specific criterion that pinpoints a particular jurisdiction's level of cooperation; rather, each state is assessed for the overall, total efficiency of its AML/CFT laws and regulations in shutting wrongdoers away from the financial sector or state's bureaucracy impeding international cooperation.

Owing to the absence of defined *modus operandi*, the rules followed do not attend to the method of determining which countries to evaluate next or how to be removed from the NCCT list. Also, the nature and size of financial centers are critical factors, although what this exactly means is not detailed in the assessments. At most, “the evaluations look at four broad areas: vagueness in financial regulations, impediments by other regulatory policies, barriers to international cooperation, and insufficient resources to prevent and detect money laundering.”⁵⁵

If a jurisdiction fails to remedy deficiencies, then, “under Recommendation 21, the FATF requires that financial institutions identify clients whose financial transactions originated or passed through a NCCT. The point is to make it difficult for individuals and entities established in the NCCT entry to the international financial

⁵⁴ Ibid.
⁵⁵ Ibid.

system. While collective action is optimal, FATF member states are free to choose whether or not to impose sanctions.”⁵⁶

Throughout the NCCT life, only two countries, which have relatively small economies and meek international relations, have been sanctioned by the FATF. “In December 2001, the FATF imposed a financial quarantine against Nauru, a listed country that had failed to adequately place money laundering controls on its large offshore financial sector, and applied similar countermeasures against Myanmar in November 2003.”⁵⁷ As a sign of progress, “the FATF revoked the counter-measures against Nauru and Myanmar, although the countries remained on the NCCT list until October 2005 and October 2006, respectively.”⁵⁸ The FATF utilizes a carrot and stick policy by means of constructive incentives by partnering with organizations, such as the International Monetary Fund, the World Bank, and the Counter-Terrorism Action Group to assess the countries with serious systematic problems and those that are in need for technical assistance, and match these needs with the donor community.

2.9 – The International Cooperation Review Group (ICRG) Process

The NCCT process’s future success was in question, denoting a stern disjuncture between the NCCT and updated recommendations pertaining to the assessment of counter-financing of terrorism. Apparently the NCCT’s enthusiasm has diminished since the terrorist attacks on the US soil; while interpretations as to the rationale for this powerlessness included diminished notice from the US -- the driving force behind the FATF.

Due to the establishment of the Department of Homeland Security, the US strategy to combat terrorist financing has been spread to a few agencies,

⁵⁶ Ibid.

⁵⁷ Ibid.

⁵⁸ Ibid.

unintentionally affecting the FATF. In the end, the NCCT program was transferred to the purview of the IMF and WB whose officials have aspired to focus on capacity building rather than the FATF's ill-fated naming and shaming mechanism.

In response to Resolution 1617, the FATF established a common methodology in 2004 to assess the level of implementation of its recommendations. The collaboration of both the IMF and WB depicts a decisive universal component to the FATF through increased peer pressure, transparency, and accountability. This departure to a more global stance, however, must be tempered with strengthening of FATF mandate and pondered against geographic equilibrium and organizational efficiency.

Starting in 2007, the International Cooperation Review Group (ICRG) monitored high-risk jurisdictions and recommended specific actions to deal with identified risks. In 2008 and 2009, "the FATF issued successive Public Statements concerning major deficiencies in the anti-money laundering and counter-financing of terrorism regimes of a number of countries including North Korea and Iran calling upon and urging all members to safeguard their financial sectors against money laundering and terrorist financing threats emanating from both North Korea and Iran."⁵⁹ "In 2009, the G-20 called upon the FATF to revive its process for assessing countries' compliance with international AML/CFT standards and to publicly identify high-risk areas by February 2010. This urge reinforced the review process previously ongoing within the FATF and to the latter adopting in June 2009 of new ICRG procedures."⁶⁰

Primal referral to the ICRG is based on the outcomes of the jurisdiction's mutual evaluation report. Eventually,

⁵⁹ FATF Public Statement, High-risk and non-cooperative jurisdictions, Rome, 22 June 2012 see at <http://www.fatf-gafi.org>

⁶⁰ Ibid.

“A jurisdiction is referred to the ICRG for a preliminary or prima facie assessment when it reflects a considerable number of deficiencies. The primary appraisal that is usually conducted by one of four Regional Review Groups (RRGs), namely the Africa/Middle East, Americas, Asia/Pacific, and Europe/Eurasia, includes outreach to the jurisdiction, with the chance to comment on the draft prima facie report. As a result, the FATF decides whether it should conduct a more in-depth review of the jurisdiction’s strategic AML/CFT deficiencies, including developing an action plan to deal with those deficiencies.”⁶¹

Based on the ICRG process’ outcomes, the FATF issued two public statements in February 2010, that were later updated in June and October 2010 and February 2011, reaffirming the FATF’s February 2009 statement that called on its members and other jurisdictions to apply effective counter-measures to guard their financial sectors from risks emanating from Iran and the Democratic People’s Republic of Korea. Whereas situation differs in each jurisdiction and each shows different levels of risks; however, “the FATF will continue to work with the jurisdictions during the implementation of their action plans until satisfactory progress has been achieved and both can be removed from public identification.”⁶²

2.10 Challenges Ahead

Since money laundering and terrorist financing are two faces of the same coin, counter-terrorist financing can draw from the FATF experience in combating money laundering. The success of FATF makes it an ideal candidate in the fight against terrorist financing by setting coordination points and providing quick responses, through active monitoring of compliance and international cooperation, and enhanced compliance with global standards.

As noted above, the FATF, through its mutual evaluation reviews, graduated peer pressure on non-complying members and the ICRG process for non-member

⁶¹ Ibid.

⁶² Gardner, Kathryn L., “Fighting Terrorism the FATF Way,” Global Governance, July-Sept 2007 Issue see at <http://www.rienner.com/uploads/49933a6177586.pdf>

states, increases the reliability of states' commitment to comply with anti-money laundering and counter-financing of terrorism global standards. By targeting financial resources, counter-terrorism policies have a big chance to be realized in fighting international terrorism.

So, is the FATF up to the task? Assessing the FATF's success is a daunting task as it is inconvenient to ascertain whether member states are complying with the FATF recommendations because of their obligation or for other motivations. Moreover, the FATF does not set equivalent weight to recommendations or a definition of what overall compliance means.

“Such imprecision and open-endedness can bind efforts to full compliance because member states may be uncertain of what sort of action is required or otherwise unwilling to move beyond the minimum. One more difficulty rests in how the organization appraises compliance. As is clear through its evaluation process, the level of compliance is the extent to which national rules reflect the FATF recommendations. However, this appraisal is incomplete since it does not attain to the country's prosecutorial or penalizing rates, a tough to call criterion.”⁶³

An effective AML/CFT system, in general, is important for addressing terrorist financing, and most measures previously focused on terrorist financing are now integrated throughout the FATF recommendations, therefore obviating the need for Special Recommendations. However, there are some recommendations that are unique to terrorist financing: Recommendation 5 (Criminalization of terrorist financing); Recommendation 6 (Targeted financial sanctions related to terrorism & terrorist financing); and Recommendation 8 (Measures to prevent the misuse of non-profit organizations). And, in 2008 the FATF's mandate was expanded to include dealing with the financing of Proliferation of Weapons of Mass Destruction (WMDs) while adopting a new Recommendation 7 aimed at ensuring consistent and effective

⁶³ Ibid.

implementation of targeted financial sanctions when these are called for by the UN Security Council.

To conclude, the FATF Methodology encompasses a four-scale category for rating the level of compliance. These are: compliant, largely compliant, partially compliant, and non-compliant. The mutual evaluation routine involves three main criteria that deal with nature of deficiency detected and related response: first, identification of the type of deficiency whether it is discrete or not, or if it is systemic or not; second, the recognition of the need for a response; and last, assessing the quality of the response, that is, whether the response correctly addresses the problem and whether the time allocated to address the deficiency is reasonable.

A shortcoming in the methodology is its lack of precision in definitions. Still, that same vagueness is what allows the FATF flexibility and irregularity in responding to specific needs and conditions of each and every state. The self-assessment exercise and mutual evaluation reviews indicate that while member states have a higher level of compliance than non-member states, the FATF still encounter non-compliance with the Nine Special Recommendations on terrorist financing from member-states.

The ills of crime and terrorism are significant and can be seen as occurring at three levels – individual and local, community and regional, and national and international. At the individual and local level, the use of commodities or services controlled by criminals has a negative impact on individuals in terms of health, personal wealth and quality of life since young people are more drawn into crime by easy money, power or sense of affiliation. In recent decades, both criminals and terrorists have committed and sponsored kidnapping, and used violence and

intimidation to coerce innocent individuals into facilitating crime and to achieve political or military objectives.

At the community and regional level, there is damage to the reputations of areas in which illegal activity is prevalent and financial losses to legitimate businesses due to being the victims of crime and terrorism. In addition, terrorist attacks also devastate the targeted local areas. The long-term effect of these activities serves to undermine public confidence in law enforcement and the wider criminal justice system.

Finally, at the national and international level, the global reach of organized crime and terrorism has weakened economies, damaged social fabric, corrupted, and caused or exacerbated the failure of states that suffer from reputational and financial impact on their institutions and economies.

In summary, following the ending of the third round of mutual evaluations of its members, the FATF, in close co-operation with the FATF-Style Regional Bodies (FSRBs) and the observer organizations, including the IMF, the WB and the UN, has reviewed and updated its recommendations. The revised recommendations address new and emerging threats, clarify and strengthen many of the existing obligations while maintaining the necessary stability and rigor, and reinforce the requirements for implementation of a Risk-Based Approach (RBA) which entails that countries should first identify, assess and understand the risks of money laundering and terrorist financing, and then adopt appropriate measures to mitigate the risks. The Risk-Based Approach allows countries to target their resources more effectively and apply preventive measures that are commensurate to the nature of risks, in order to focus and utilize their efforts and resources more efficiently.

Not only the FATF is committed to maintaining a close and constructive dialogue with the private sector, civil society and parties, as important partners in ensuring the integrity of the international financial system; but it also calls upon all countries to implement effective measures to bring their national AML/CFT systems into compliance with the revised FATF Recommendations.

Why then fear the OFAC List? In response to September 11 terrorist attacks, US Congress passed the PATRIOT Act. Title III of the PATRIOT Act is the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. It is arguably the single most significant AML law that Congress has enacted since the Currency and Foreign Transactions Reporting Act commonly known as the Bank Secrecy Act (BSA) itself.

Among other things, the PATRIOT Act criminalized the financing of terrorism and augmented the existing BSA framework by strengthening customer identification procedures; prohibiting financial institutions from engaging in business with foreign shell banks; requiring financial institutions to have due diligence procedures and, in some cases, enhanced due diligence procedures for foreign correspondent and private banking accounts; and improving information sharing between financial institutions and the US government. We now turn to the next chapter that will discuss extensively terrorism, foreign policy, and US money laundering laws.

CHAPTER THREE

US FOREIGN POLICY & MONEY LAUNDERING LAWS

This chapter will focus on US international politics, highlighting money laundering laws and laying the groundwork for how this impacts the international standards and ultimately similar laws and policies in Lebanon. On October 26, 2001, President George W. Bush signed the most far-reaching law enacted in the United States since the New Deal legislation of Franklin Roosevelt's time. The USA Patriot Act of 2001 bolsters the potency of the money laundering laws and Bank Secrecy Act to levels unseen since they were enacted in 1986 and 1970 respectively. Encouraged by the strong congressional desire to close the avenues of terrorist financing, the laws now reach levels of coverage and scope that would not have been possible had it not been for the events of 9/11. The Patriot Act had left no part of the world or financial institution or business anywhere beyond the reach of the United States government.

3.1 Background

Settling into the White House in 1993, Bill Clinton had undeniably inherited a shiny new world. It was more permissive than any other encountered by an American president in the twentieth century. And American power, no longer trammled by the Soviet Union, stood at its historical apex.

“Because we remain the world's indispensable nation,” Clinton intoned in 1996, “we must act and we must lead.”⁶⁴ This was the mantra of a presidency sitting on top of the world. “If the United States does not lead, the job will not

⁶⁴ “Acceptance Speech at the Democratic National Convention, Foreign Policy Excerpts,” August 29, 1996, <http://www.4president.org/speeches/clintongore1996convention.htm>

be done... Our leadership is essential... American leadership is indispensable... We have to assume the burden of leadership.”⁶⁵

Then came 9/11, and exuberance changed into fear and fury. At least in terms of U.S. grand strategy, nothing would ever be the same again, as the phrase of the day had it. What had changed? On September the 11th, “enemies of freedom committed an act of war against our country,”⁶⁶ President Bush intoned. “Americans have known wars – but for the past 136 years, they have been wars on foreign soil. ... Americans have known the casualties of war – but not at the center of a great city. ... Americans have known surprise attacks – but never before on thousands of civilians.”⁶⁷ Henceforth, the shock of 9/11 – a vulnerability America had never experienced – would course through the corridors of American power.

The United States has often opted for a one-sided approach in foreign policy; yet in the war against terrorism it has followed a global approach. Foreign policy is often identified as an element of domestic policy. Kenneth Waltz, for example, highlights the similarity of foreign policy behavior amongst states with diverse political orders, and argues that “if any state was to become a model for the rest of the world, one would have to conclude that most of the impetus behind foreign policy is internally generated.”⁶⁸

U.S. foreign policy has proven inconsistent in the last decade mainly due to inside changes as well as in the international system. Foreign policy decision-makers operate within the confines of the international system. In *War and Change in World Politics*, Robert Gilpin (1987) observes another form of system change: “where states

⁶⁵ “Remarks by the President in Freedom House Speech, Washington, October 6, 1995, <http://www.clintonfoundation.org/legacy/100695-speech-by-president-in-freedom-house-speech.htm>

⁶⁶ “Address to Joint Session of Congress and the American People,” September 20, 2001, <http://www.whitehouse.gov/news/releases/2001/09/print/200109208.html>

⁶⁷ Ibid.

⁶⁸ Waltz, Kenneth, “America as a Model for the World,” *PS: Political Science and Politics*, Vol.24, no.4 (1991), p. 667.

act to preserve their own welfare and thereby change the international system. Such changes can occur because states react differently to political, economic, and technological developments.”⁶⁹ Gilpin finds that “the distribution of power among states constitutes the principal form of control in every international system.”⁷⁰ Accepting the realist assumptions that states are the principal actors, decision-makers are basically rational, and the international system structure plays a key role in determining power, Gilpin adds the notion of dynamism, of history as a series of cycles of birth, expansion, and demise of dominant powers on the basis of the importance of economic power.

While liberal internationalists such as Fukuyama who claims that “the projection of liberal-democratic principles to the international realm is said to provide the best prospect for a peaceful world order because a world made up of liberal democracies... should have much less incentive for war, since all nations would reciprocally recognize one another’s legitimacy;”⁷¹ neo-realists emphasize system structure and balance of power. Waltz and Mearsheimer argue that “the moral aspirations of states are thwarted by the absence of an overarching authority which regulates their behavior towards each other. The anarchical nature of the international system homogenizes foreign policy behavior by socializing states into the system of power politics. The requirements of strategic power and security are paramount in an insecure world, and they soon override the ethical pursuits of states, regardless of their domestic political complexions.”⁷²

⁶⁹ Gilpin, Robert, *War and Change in World Politics*, (Cambridge, UK: Cambridge University Press, 1981).

⁷⁰ Ibid.

⁷¹ Fukuyama, Francis, *The End of History and the Last Man*, (New York, 1992), pp. xi-xii and 48.

⁷² Mearsheimer, J. L., “Back to the Future: Instability in Europe after the Cold War,” *International Security*, vol. 15, no. 1 (Summer 1990), p. 6; Waltz (1991), p. 669.

Responding to the 9/11 attacks, the United States declared war on terrorism and that a situation of armed conflict exists (Public Law No. 107-40). When the U.N. General Assembly invoked Article 51 of its Charter, it agreed to the U.S. response for authorization for the use military power as based on the right of self-defense. In this regard, the General Assembly determined that acts of terrorism represented an armed assault. President Bush has constantly referred to the situation as one of war.

3.2 U.S. Money Laundering Laws

There's no better way to describe the dramatic global impact of the United States money laundering laws than by ascribing to them the traits of those who share October birthdays. The most significant of those laws would be Scorpios – a sign described as strong and self-reliant with a deep inner sense of authority and power. For better or worse, these attributes describe the U.S. money laundering law and the USA Patriot Act.

Congress took action against money laundering on October 26, 1970 when it passed the Bank Secrecy Act (BSA), a law directing the U.S. Treasury Department to create regulations requiring financial institutions to report large cash transactions. Sixteen years and a day later, former President Ronald Reagan created the nation's first money laundering laws with the stroke of a pen when he signed the Money Laundering Control Act into law on October 27, 1986. Fifteen additional years later, President George W. Bush signed the USA Patriot Act into law on October 26, 2001, just 45 days after 9/11. It gave rise to many bold regulations that are felt by thousands of institutions and individuals all over the world. It also strengthened the money laundering law by increasing its power over persons and institutions who handle foreign corruption proceeds.

The United States was the first nation to criminalize money laundering through a laundering law that relates to the proceeds of a wide range of crimes (Title 18, U.S. Code Sec. 1956) and imposes penalties of up to 20 years in prison. It also includes an exclusive provision that prohibits financial transactions concerning the proceeds of, or for the purpose of promoting, nearly 200 Specified Unlawful Activities (SUAs), which are crimes that generate profit such as terrorism, government procurement fraud, bank fraud, espionage, kidnapping, narcotics offenses and others, including certain foreign crimes (Title 18, USC Sec. 1956(c) (7)).

The Monetary Transaction crime, an additional federal criminal money laundering law which has minor penalties (Title 18, USC Sec. 1957), makes it a crime for anyone to knowingly engage in a monetary transaction, such as a deposit or transfer of cash or purchase of a monetary instrument, involving property of \$10,000 or more... derived from specified unlawful activity, which is defined by incorporating the list of SUAs listed in the accompanying stronger money laundering law at section 1956. The third money laundering law makes it a crime to manage an unlicensed money transmitting businesses even where the person did not know it was a crime to run such a company in the state where it is incorporated (Title 18, USC Sec. 1960).

3.2.1 The Kerry Amendment

In the mid-1980s, then U.S. Democratic Senator John Kerry had been extensively involved in investigation into money laundering by the notorious Bank of Credit and Commerce International (BCCI). In 1988, he authored the first U.S. law, called the Kerry Amendment, to impose sanctions on countries that do not cooperate with U.S. anti-money laundering (AML) efforts. “We find ourselves in a position where we are compelled by the globalization of crime to globalize law and law

enforcement, Kerry wrote in his 1997 book, *The New War: the Web of Crime That Threatens Society*.⁷³

The Kerry Amendment to the Anti-Drug Abuse Act of 1988 preceded the FATF's and OECD's efforts to black-list non-compliant countries. The amendment called for the Department of Treasury to negotiate information-sharing agreements with foreign countries covering money laundering cases and currency transactions over \$10,000. Individuals and banks that did not share information could be barred from the U.S. wire transfer and dollar clearing systems or prohibited from opening U.S. accounts. Hereafter, the Treasury Department criticized the measure, according to a 1990 Treasury statement; it said many countries will resist being pressured into bilateral agreements conceived unilaterally by the U.S.

In 1992 Kerry and Colorado Republican Senator Hank Brown issued a Senate committee report on their investigation, The BCCI Affair, which was also known as the Kerry Report. The 785-page report's first recommendation was that "the U.S. should take firm action against nations who permit their privacy and confidentiality laws to protect criminals from U.S. regulators and law enforcement. Current toleration by the U.S. of bank secrecy and regulatory havens needs to be replaced by a policy that threatens to withhold access to the U.S. market for banks doing business in any nation that does not meet minimum standards for regulation and the sharing of information with the U.S."⁷⁴

Months before 9/11, Kerry sponsored the International Counter-Money Laundering and Foreign Corruption Act, which would have authorized Treasury to require financial institutions to file suspicious activity reports on transactions involving any person or jurisdiction deemed a primary money laundering concern.

⁷³ Kerry, John, *The New War: The Web of Crime That Threatens America's Security*, (Touchstone, June 1, 1998).

⁷⁴ Ibid.

Financial institutions would have been required to identify the owner of any account opened or maintained by a foreign person. The bill which did not pass was criticized for giving Treasury too much power. After 9/11, however, Kerry was a major player in getting these provisions incorporated into the USA Patriot Act.

3.3 The USA Patriot Act

U.S. President George W. Bush has made his mark in the world of money laundering and terrorist financing – whether by choice or circumstance, however, remains an open question. Once in office, the Bush administration withdrew U.S. support for the multinational Organization for Economic Co-operation and Development's efforts to sanction offshore laundering havens. It also contemplated a regulatory overhaul to ease the burden of current compliance requirements on financial institutions, and paid little attention to the fact that the U.S. ranked 26th of 29 countries in its adherence to the FATF's 40 Recommendations.

Then came 9/11, and the Bush administration made a 180-degree turn concerning terrorism financing and money laundering. Under pressure from the White House, the USA Patriot Act became law on October 26, 2001. The USA Patriot Act (Public Law No. 107-56) reinforced the influence of the money laundering laws and Bank Secrecy Act to unprecedented ranks since they were enacted in 1986 and 1970 respectively. The Bank Secrecy Act was amended more than 50 times, and three money laundering laws and the forfeiture laws were strengthened above all in their outreach that would not have been possible had it not been for the events of 9/11.

The Patriot Act re-defined international acts of terrorism so as to incorporate activities of mass destruction intended to influence the behavior of government. It defined domestic terrorism to include activities that occur primarily on U.S. soil. This law has left no part of the globe or financial institution or business anywhere beyond

the reach of the U.S. government. It also altered the features of the money laundering field forever as is evident from the AML Program requirements that would include internal policies, procedures, and controls, designation of a compliance officer, setting employee training programs, and performing independent audit functions to test programs.

The Patriot Act covers a wide range of money laundering and terrorism financing issues. Amongst its requirements, and the most far-reaching, is the one that authorizes the Treasury to stipulate special measures that financial institutions have to pursue in their business with private banking accounts, correspondent accounts and countries at any time the Treasury resolves to. The statute's vast provisions calling for record keeping and other reports have been condemned as imposing sharp costs as well as serious restraints on sovereignty and freedom of expression.

The Patriot Act modified the civil penalty section of the money laundering law (Title 18, USC Sec. 1956 (b)) to permit for civil lawsuits for violation of the second money laundering law that prohibits money transactions in property derived from specified unlawful activity (Title 18, USC Sec. 1957) allowing prosecutors to exact monetary fines from individuals and businesses that deliberately partake in monetary transactions without having to set up the more complex objectives and intentionality that the laundering law requires (Title 18, USC Sec. 1956 (a)).

3.3.1 A Deluge of Regulations

The regulations spawned by the USA Patriot Act, which are codified in Title 31 of the Code of Federal Regulations (CFR), Part III, have turned the money laundering control world on its head. Of the Patriot Act's eleven titles, Title III was devoted exclusively to terrorist financing, Bank Secrecy Act and money laundering

subjects. Listed below is a briefing of the most revolutionary Patriot Act provisions and their impact:

- i. Section 311 (Special Measures) authorizes the U.S. Treasury to designate countries, individuals or institutions as primary money laundering concerns and to impose special measures against them.
- ii. Section 312 (Due Diligence for Correspondent & Private Banking Accounts) is the most controversial and far reaching provision of the Act. Section 312 puts tens of thousands of non-United States financial institutions and wealthy persons who are correspondent and private banking customers of U.S. banks, securities dealers and mutual funds under greater scrutiny through special due diligence the U.S. institutions must exercise.
- iii. Section 313 (Prohibition on US Accounts with Foreign Shell Banks Accounts) as companion to Section 312, prohibits foreign shell banks – those without a physical presence – from maintaining correspondent accounts at U.S. financial institutions. It also requires covered U.S. institutions to take reasonable steps to ensure that a foreign correspondent account is not being used to provide banking services indirectly to a shell bank. Sometimes called nesting, this refers to the ability of one foreign bank to use another foreign bank’s correspondent accounts.
- iv. Sections 314(a) and (b) (Cooperative Efforts to Deter Money Laundering) opened unprecedented routes for U.S. financial institutions to share with U.S. law enforcement agencies and other institutions customer information of possible terrorist or money laundering activities. Section 314(a) allows federal enforcement agencies, through FinCEN, to request, without subpoena or legal process that financial institutions search their accounts and review transactions of named individuals or organizations suspected of money laundering or terrorist financing.

Section 314(b) allows financial institutions that must maintain AML programs to exchange with such institutions customer information if money laundering or terrorist financing are suspected. For these exchanges, which require a notice to Treasury, Congress lifted the obligations of the financial privacy provisions of the Gramm-Leach-Bliley Law.

- v. Section 319 targets funds in US interbank accounts and bank records. Now codified as part of the U.S. forfeiture law (Title 18, U.S. Code Section 981(k)), it is one of the most aggressive money laundering-related enactments under the Patriot Act. It raises significant risks for international banks by allowing U.S. prosecutors, with federal court approval, to seize funds in a foreign bank’s U.S. inter-bank account equivalent to the funds held by the foreign bank’s targeted customer in the overseas institution. The DOJ does not acknowledge or reveal the true number of foreign banks’ seized accounts.

- vi. Section 326 (Verification of Identification) requires banks, broker dealers and certain others to maintain a four-pronged, risk-based customer identification program that, among other things must be approved by the board of directors and form a part of the AML program.
- vii. Section 352 (Anti-Money Laundering Programs) requires industries and businesses that are classified as financial institutions under the BSA to maintain a four-pronged, risk-based AML program (Title 31, USC Section 5312(a)(2)), unless Treasury exempts them. The AML program must include board-approved written policies and procedures, designation of a compliance officer, continual employee training, and independent testing of the program.

In addition to strengthening requirements of the BSA, the new AML provisions are clearly focused on dealing with perceived gaps in regulation of correspondent banking and private banking accounts. Provisions codify industry best practices in terms of adequate controls relative to verification of customer identity – including upfront list checking, a detailed understanding of customer business, business partners, and source of funds – as well as ongoing monitoring of high-risk accounts. The inclusion of anti-terrorist considerations into money laundering prevention regulations marries OFAC-type list access with ongoing analyses of the sources and usage of funds. Enhanced scrutiny of accounts and transaction activity extends the need for inclusive or enterprise-wide anti-money laundering systems, a greater know-your-customer insight relative to account ownership and usage, and a more forensic approach to identification and analysis of potentially suspicious transaction activity.

The Act employs the carrot-and-stick approach to foreign entities; on the one hand seeking assistance of foreign governments and financial institutions to combat terrorism and money laundering, and on the other, instituting long-arm jurisdiction and other controls over foreign bank funds, primarily through U.S. correspondent accounts and interbank accounts by means of its extraterritorial reach provisions.

3.3.2 Extraterritorial Reach of U.S. Money Laundering Law

The U.S. money laundering law includes an extraterritorial reach if the offense is committed by a U.S. citizen or by a foreign national who conducts at least part of the offense in the U.S., and if the transaction entails more than \$10,000. The law contains several provisions that extend its prohibitions and powerful sanctions into foreign countries and institutions, businesses and individuals. Extraterritorial jurisdictions of the primary U.S. money laundering law can relate to a financial transaction that occurs in whole or part in the U.S. if the funds involved were resulting from purely overseas crimes that incorporate drug trafficking, extortion, foreign corruption, fraud against a foreign bank, kidnapping, robbery, or destruction of property by explosion or fire (Title 18, USC Sec. 1956(I)).

One of the three prongs of the money laundering law deals entirely with the international transportation, transmissions or transfers, from or to the United States, of funds if processed with the intent to promote the carrying on of specified unlawful activity, or with knowledge that the funds are from some form of unlawful activity to conceal or disguise the nature, location, source, ownership or control of the funds or avoid a federal or state transaction reporting requirement.

3.3.3 Civil Money Laundering Lawsuits by the U.S. Government

In addition to its heavy criminal penalties of up to five years in prison, the law permits for civil penalty lawsuits by the government for the value of the funds or property involved in the transaction. The civil penalty clause was significantly bolstered by the Patriot Act, making it now permissible to assign a *federal receiver* to collect and take possession of the assets of a foreign person or entity who is facing a money laundering civil suit by the U.S. government (Title 18, USC Sec. 1956(b)).

The U.S. Department of Justice has the exclusive power under the money laundering law to follow civil lawsuits against financial institutions, businesses and persons even though they are not charged with the crime of money laundering on the basis of allegations that they laundered money. In the case of an institution, the lawsuits seek recovery of the amount of money laundered through the institution by its employees (Title 18, USC Sec. 1956(b)).

3.4 Suppression of the Financing of Terrorism Implementation Act

On September 24, 2001 the President signed into law a broad Executive Order (EO) 13224 blocking the assets of, and prohibiting dealings with, 27 persons and entities alleged to be terrorists or fronts, including Osama bin Laden and Al Qaeda group (Title 50, USC Section 1702). That meant closing the door to U.S. financial system and dollar clearance services and seizure of accounts of foreign accomplice financial institutions, including their correspondent accounts at U.S. banks.

The Order also empowered Treasury to impose financial sanctions on terrorist-related entities worldwide that it deemed as *Specially Designated Global Terrorists* (SDGT). The Treasury Department has the power under the President's Order to deny any advantage to foreign financial institutions in their transactions with U.S. banks. That includes, among other provisions, the maintenance of correspondent accounts. It allows the Secretary to re-delegate any of these functions to other U.S. agencies, including FinCEN, Federal Reserve Board (FRB) and Securities and Exchange Commission (SEC).

Title III of the Patriot Act amended existing anti-money laundering provisions of the BSA to endorse prevention, detection, and trial of international money laundering and terrorist financing. The USA Patriot Act increased the power of Treasury and other federal agencies and departments to combat money laundering and terrorism by providing them with more control over, and information from, financial institutions. The Securities and Exchange Commission (SEC) and the Commodity

Futures Trading Commission (CFTC) are added to the list of functional industry regulators under the BSA, which includes the Federal Reserve Bank, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the Credit Union National Association (CUNA).

3.4.1 Agency Shake-Up

Treasury's Terrorist Financial Asset Tracking Center became operational right after September 11, even though it had been funded since October 2000. But the new Department of Homeland Security (DHS) in March 2003 took on much of Treasury's AML and counter-terrorist financing workforce, including U.S. Customs Service agents at *Operation Green Quest* who had been given a mandate to investigate terrorist financing cases, and the Secret Service. In the meantime, the FBI had already established a Terrorism Financing Operation Section (TFOS), which conducts financial analysis of terrorism suspects and coordinates the sharing of information between government and intelligence agencies. The FBI also launched the Joint Terrorism Task Forces (JTTF), often composed of FBI agents, IRS-CID (Criminal Investigation Division) agents and local police, which investigate terrorism financing crimes across the United States.

The Department of Homeland Security had access to information gathered by the Central Intelligence Agency (CIA), the National Security Agency (NSA) and other agencies. All have a financial component that includes IRS-CID agents and local police. The agents also enjoy access to all financial databases of the U.S. government, including the Treasury Department's Currency Banking Retrieval System (CBRS), which contains all the forms filed under the Bank Secrecy Act. The

CBRS provides access to millions of forms filed reporting, among other things, suspicious activity, currency transactions and border currency reports.

Subsequent tension between DHS and the FBI resulted in the FBI being given the lead role in terrorism financing investigations. The IRS-CID, which employs some of the most highly-skilled financial investigators in the world, continues to investigate terrorism financing cases through JTTFs. The shake-up has left three departments competing for much the same anti-terrorist finance funding. But the General Accounting Office, the congressional watchdog agency, concluded in a May 2004 report that progress has been made in waging a coordinated campaign against sources of terrorist financing.

3.4.2 The 9/11 Commission's Report on Terrorist Financing

The 9/11 Commission's report on terrorist financing criticized U.S. efforts to freeze and seize terrorist assets following the attacks on the World Trade Center. The two documents substantially detail the great challenge that public and private institutions face in starving terrorists of their funds.

Before 9/11, terrorist financing was not considered important enough by the Treasury Department to be included in the National Money Laundering Strategy, according to the report that was released on July 22, 2004. Treasury regulators, as well as U.S. financial institutions, were generally focused on finding and deterring or disrupting the vast flows of U.S. currency generated by drug trafficking and high-level international fraud. Since then, "the focus has been on freezing terrorist assets instead of following where they might lead, and to date, the origin of the 9/11 funds – estimated at between \$400,000 and \$500,000 – remains unknown."⁷⁵

⁷⁵ Money Laundering Alert, "9/11 reports call for following, not freezing, terror money," (September 2004), pp. 9 and 14. See at <http://www.moneylaunderingalert.com>

Shortly after signing Executive Order (EO) 13224, the Treasury's Office of Foreign Assets Control (OFAC), who relied on a *derivative designation theory* in which no direct proof of culpability was needed, blocked nearly \$142 million worldwide in terrorist assets with the assistance of foreign governments, the Commission said and, as a result, some evidentiary foundations for early designations were quite weak. But simply freezing terrorist funding has done little to disrupt the flow of money, according to the main Commission's report. "Al Qaeda had many other avenues of funding and if a particular source of funds dried up, it could have easily tapped a different source to fund an attack such as the 9/11. The Commission concluded that the overall or long-term effect of blocking terrorist-related assets is not clear."⁷⁶

Although Treasury had been appropriated \$6.4 million for an all-source terrorist financing intelligence analysis center called the Foreign Terrorist Asset Tracking Center (FTATC) in October 2000, it remained inactive until after 9/11. The CIA believed that the FTATC would duplicate some of its functions, as well as the FBI has never put to use significant financial intelligence on specific terrorist groups before the 9/11 attacks by developing criminal cases or disrupting lines of funding. "There was a fairly rigid rule within the FBI and Department of Justice against mingling intelligence cases and law enforcement cases. In the jargon of the day, this prohibition was known as *the wall*, the Commission said."⁷⁷

3.4.3 The Saudi Connection

Critics have also faulted the administration for its relationship with Saudi Arabia, identified as the primary source of money for Al Qaeda both before and after the 9/11 attacks. The Saudis did not cooperate with U.S. efforts to disrupt terrorist

⁷⁶ Ibid.

⁷⁷ Ibid.

financing until after Al Qaeda attacks on their own soil of May 12, 2003, according to the 9/11 Commission report.

U.S. Senator John Kerry has voiced full support for the 9/11 Commission report's recommendations which include making the tracking of terrorist financing front and center in U.S. counter-terrorism efforts. He promised to name and shame terrorist financiers, sanction foreign banks that engage in money laundering, and get tougher on Saudi Arabia – “ending what he called the Bush administration's *kid-glove approach*.”⁷⁸ While Kerry belittled Saudi Arabia's efforts to combat terrorist financing, the Financial Action Task Force 2003-2004 Annual Report stated that “Saudi Arabia has focused heavily on systems and measures to counter terrorism and the financing of terrorism, has already established systems for tracing and freezing terrorist assets, and is *largely compliant* with the FATF's recommendations on money laundering and terrorist financing.”⁷⁹

3.5 Unilateralism a Liability

AML experts agree that the war against money laundering and terrorism requires multinational cooperation. Some criticized the Bush administration's unilateralism as an impediment to these efforts stating that foreign policy is one of the most important anti-money laundering tools – “being a better multilateral player and not being seen as interfering in the internal affairs of countries.”⁸⁰ Others are even of the opinion that “Bush's foreign policy has greatly exacerbated the money laundering and terrorist financing problems; the failure to grapple with the Israeli/Palestine crisis,

⁷⁸ Money Laundering Alert, “Kerry has long history in money laundering laws, investigations”, (September 2004), pp. 4-5. See at <http://www.moneylaunderingalert.com>

⁷⁹ Ibid.

⁸⁰ Money Laundering Alert, “Bush's AML strategy: here today, but what comes tomorrow?” (October 2004), pp. 6-7. See at <http://www.moneylaunderingalert.com>

the pre-emptive war on Iraq, all contributed to the political capital and leadership of the U.S. being dramatically deteriorated.”⁸¹

Deputy Assistant Secretary Daniel Glazer stated that “the U.S. continues to work with other partner financial centers to develop and maintain effective international standards to protect the financial system against illicit financing. Above all, the Treasury is promoting this strategic objective with the FATF through its recommendations, guidelines, and best practices for combating money laundering and the financing of terrorism. It also supports the development of relevant resolutions at the U.N. These standards assist countries in developing their own anti-money laundering and counter-terrorist financing laws and regulations.”⁸²

Since before 9/11, the U.S. Treasury has consistently engaged the FATF to expand its recommendations to address the systemic vulnerabilities that terrorists and other criminals may exploit through the development of Nine Special Recommendations on Terrorist Financing and revision of the FATF 40 Recommendations. These standard-setting efforts at FATF and U.N. levels create a global obligation and framework for countries to implement AML/CFT regimes that effectively protect the international financial system against all forms of illicit finance and criminal abuse.

Major work has been closely conducted with interagency partners and international counterparts to establish a comprehensive global system of AML/CFT assessments through FATF, FSRBs, World Bank and International Monetary Fund. Through the FATF and FSRBs mutual evaluation process, Treasury has directly participated in the assessments of several strategically essential countries. In brief, the FATF identifies strengths and weaknesses in a jurisdiction’s AML/CFT regime and assures that deficiencies are being addressed. One potentially appropriate governmental response to systemic vulnerabilities created by jurisdictional AML/CFT

⁸¹ Ibid.

⁸² The U.S. Department of the Treasury (Terrorist Financing and Financial Crimes), “Testimony before the Senate Committee on Banking, Housing and Urban Affairs,” Press Room (September 2006), see at <http://www.treas.gov/press/releases/hp93.htm>

deficiencies is providing technical assistance by the Treasury to aid compliance with international standards in support of the broader U.S. government task in combating terrorist financing and to facilitate the development of transparent and accountable financial systems in strategic countries of concern.

“A significant part of Treasury’s mission is devoted to U.S. government efforts to secure international support and implementation of targeted financial sanctions, actions through a variety of activities, including by maintaining a dialogue with other countries regarding the financial actions that are needed to disrupt specific terrorist cells or networks and also by working to strengthen other countries’ capacity and ability to implement targeted financial sanctions. Through the U.S. government’s efforts with the EU, the FATF, the G-7 and others, other countries were able to develop national sanctions authorities and to improve cooperation in implementing asset freezes. In many cases, countries have joined the U.S. in imposing sanctions on U.S.-designated individuals and entities, either independently or through action at the U.N. Security Council. This global designation program, overseen by the U.N.’s 1267 Committee, is a powerful tool for global action against supporters of Al Qaeda.”⁸³

3.6 Protests to Extra-Territorial Reach of US Asset Forfeiture Law

Heightened concerns regarding Section 319(a) of the USA Patriot Act, that gives the government sweeping authority to seize and forfeit money from the U.S. accounts of foreign banks, have prompted the European Banking Industry Committee (EBIC), a trade association, to address the problem in a working paper that was released in May 2005 re-assessing the effect and impact of the law on European banks that hold interbank accounts in the United States.

Section 319(a) of the USA Patriot Act that was made part of the U.S. civil forfeiture law (Title 18, USC Sec. 981(k)) states in part that, “if funds are deposited into an account at a foreign bank and that foreign bank has an interbank account in the United States... the funds shall be deemed to have been deposited into the interbank

⁸³ Ibid.

account.”⁸⁴ That means, any seizure warrant for those funds, “may be served on the U.S. financial institution, and funds in the interbank account, up to the value... deposited into... foreign bank account, may be... seized...”⁸⁵ In addition, the seized money need not be related to the suspected criminal funds overseas. The foreign bank whose funds are seized may challenge the U.S. government’s seizure under limited circumstances. However, the owner of the funds is welcome to challenge the U.S. action if he or she dares to appear in U.S. court.

The EBIC considered adopting a regulation similar to a 1996 blocking statute – a response to strengthened U.S. economic sanctions against Cuba (EC No. 2271/96). The statute protected EU member states from the effects of extraterritorial applications of the Helms-Burton Act and actions resulting from it, by making the adherence to the economic sanctions against Cuba in that legislation illegal within the EU. Just the threat of such a response would force U.S. agencies to carefully consider applying Section 319(a), thus making actual implementation of protective legislation unnecessary.

Another concern was that the provision could be used to seize the U.S. accounts of foreign banks for violating Office of Foreign Assets Control economic sanctions. OFAC sanctions apply only to U.S. persons and entities; non-U.S. institutions outside the U.S. are not obligated to reject business with or block assets of entities on OFAC blacklists. In practice, however, problems have arisen when overseas banks move to recover funds seized from their accounts in the United States.

Diplomatic protests from the Swiss and other governments caused the Justice Department to instruct the 93 U.S. Attorney’s Offices around the nation to obtain approval from Main Justice in Washington D.C. before applying Section 319(a). In

⁸⁴ Ibid.
⁸⁵ Ibid.

response, the U.S. government said that it shall use the provision only when Mutual Legal Assistance Treaties (MLATs) fail. MLATs make it easier to obtain investigative assistance from other countries by allowing one country's law enforcement agency to make requests to its foreign counterpart through diplomatic channels. But obtaining foreign legal assistance is a lengthy, time-consuming process. All requests must be approved by the Justice Department Office of International Affairs, which forwards them to its foreign counterpart, which passes them to local enforcement agencies. By contrast, Section 319 allows U.S. enforcement agencies to short-circuit the whole process.

Moving to the next section of the thesis, it is worth mentioning that major progress has been made, since 9/11, in creating and deploying financial measures to identify, disrupt and dismantle the financial networks that facilitate and support terrorism. Through the adoption of UNSCRs 1267 and 1373, the U.S. has created an effective global framework with obligations to ensure that the international financial system is a hostile working environment for those who support terrorist financing.

3.7 The United Nations Security Council Resolutions

On September 28, 2001, the Security Council unanimously adopted Resolution 1373 which requires, among other things, the freezing of terrorist assets, placing barriers on the movement, organization and fund-raising activities of terrorist groups. It recalled provisions from previous resolutions 1189 (1998), 1269 (1999) and 1368 (2001) concerning terrorism. U.N. member states were expected to share their intelligence on terrorist groups in order to assist in combating international terrorism.

Resolution 1373 calls on all states "to adjust their national laws in order to ratify all existing international conventions on terrorism. It affirmed that all States should also ensure that terrorist acts are established as serious criminal offenses in

domestic laws and regulations and that the seriousness of such acts is duly reflected in sentences served.”⁸⁶

It also aims at restricting immigration laws, declaring that before granting refugee status, “all States should take appropriate measures to ensure that the asylum seekers had not planned or facilitated or participated in terrorist acts. In addition, States should ensure that refugee status was not abused by the perpetrators, organizers or facilitators of terrorist acts, and that claims of political motivation were not accepted as basis for refusing requests for the extradition of alleged terrorists.”⁸⁷

Unlike treaties or conventions that require subsequent steps, Security Council resolutions, when issued, bind all its 191 U.N. member states. The Security Council’s act, in placing Resolution 1373 under Chapter VII of the U.N. Charter, signifies the urgency of its response. That Chapter authorized the Security Council to enforce the terms of a resolution by use of measures ranging from economic sanctions to the use of military force. Resolution 1373 requires that “states should afford one another the greatest measure of assistance for criminal investigations or criminal proceedings relating to the financing or support of terrorist acts.”⁸⁸

In effect, the Security Council established the Counter-Terrorism Committee (CTC) to monitor the improvement of adherence by nations to the resolution. However, the resolution failed to define terrorism, and the working group initially only added Al-Qaeda and Taliban regime of Afghanistan on the sanctions list. This also entailed the possibility that authoritarian regimes brand even non-violent activists as terrorists, and hence infringing upon basic human rights.

⁸⁶ United Nations Security Council Unanimously Adopts Wide-Ranging Anti-Terrorism Resolution, Calls for Suppressing Financing, Improving International Cooperation, Press Release SC/7158, UN (28/09/2001) see at <http://www.un.org/news/press/docs/2001/sc7158.doc.htm>

⁸⁷ Ibid.

⁸⁸ Ibid.

The absence of any specific reference to human rights considerations was remedied in part by Resolution 1456 (2003) which affirmed that “states must ensure that any measure taken to combat terrorism comply with all their obligations under international law, and should adopt such measures in accordance with international law, in particular, international human rights, refugee, and humanitarian law.”⁸⁹

Apparently, a definition of terrorism was a highly complex and, probably, at the international level, a controversial undertaking. At the end of January 2002, U.N. member states debated the terrorist-definition problem. It was obvious that member states were distant on the issue of the meaning and legality of terrorism. Disapproval was expressed by the 56-member Organization of Islamic Conference to any terrorist-definition that would not relate to the notion of freedom fighters. They rejected any definition that might impede national liberation movements, or resistance to foreign occupation.

Founded in concerns over violations of national sovereignty because of foreign intervention, the political convictions of opposing states are hard to overcome. The international definition of acts of terrorism will have to face challenges posed by opposing ideological and cultural views, as bigoted by different responses to multilateralism and unilateralism. Thereafter, the UNSCR 1566 picked up loose ends by actually explaining what the Security Council considers as terrorism: “criminal acts, including against civilians, committed with the intent to cause death or serious bodily injury, or taking of hostages, with the purpose to provoke a state of terror in the general public or in a group of persons or particular persons, intimidate a population or compel a government or an international organization to do or to abstain from

⁸⁹ Ibid.

doing any act.”⁹⁰ Resolution 1566 also called for the creation of a working group that will expand the list of terrorist entities under sanction beyond the Taliban and Al Qaeda sanctions list.

In post-9/11 era, the world faces two unique, but overlapping, problems; one is the threat of the global terrorists, who survive in states but are not always directly supported by them and the threat of state-sponsors of terrorism dedicated to acquiring weapons of mass destruction. With respect to states, it is a particular challenge to limit or, preferably, halt altogether their ability to use the international financial system to support their threatening behavior. The strategies needed to be employed to combat the threats posed by North Korea, Iran and Syria are good examples of the ways in which financial authorities are effective in dealing with state-sponsors of terrorism.

Nearly 18 months after it became open for signature in December 1999, the United Nations Convention for the Suppression of Financing of Terrorism rested mainly overlooked and forgotten. That changed after 9/11. Signed by the U.S. on January 20, 2002 and led by the initiative of the UNSCR 1373 at end of September 2002, the stale but potent international agreement has new life prompting a global effort to obstruct the financing of terrorism and terrorist acts. Before 9/11, only 41 states had signed the convention. Since then, 91 more states have done so. Lebanon has not acceded to the U.N. Convention, though it has adopted laws domestically criminalizing any funds resulting from the financing or contribution to the financing of terrorism.

International economic sanctions have become horrific to developing countries, their economies, and individuals. Proven potent global tools, economic sanctions drive governments, economies and individuals to be held accountable,

⁹⁰ Ibid.

leaving them no choice but to comply with international standards and commit to the global fight against money laundering and terrorist financing. In end of 2010, Lebanon's financial system have been put under scrutinized pressure by the US Treasury over allegations that the Lebanese Canadian Bank was involved in maintaining accounts of a money laundering and drug-trafficking international network linked to Hezbollah. Judicial procedures by the US government against international financial institutions such as Standard Chartered Bank and HSBC has cost both institutions to pay heavy monetary fines of which 1.9 billion was paid by HSBC alone on charges of dealing with private banking accounts of drug cartels in Mexico as well as defying economic sanctions by allowing financial transactions with Iran, Syria, Libya, Sudan, and Burma (Myanmar). Therefore, Lebanon had to act fast.

3.8 Lebanese Banks' Money Laundering Concerns

“Lebanon's banking system provides the means by which Iran transacts funds transfers to evade the effects of sanctions and the growing international financial blockade against Iran, and allows the money transfers that support illicit weapons and other transactions, including with Syria. New York based United against a Nuclear Iran (UANI) made public the results of a three-month, confidential investigation into the influence of Iran and Hezbollah on Lebanon's banking system and sovereign bond market. The group says Lebanon's financial system – including Banque du Liban, the country's central bank – is being used to funnel massive amounts of illicit cash for Hezbollah and its state sponsor, Iran.”⁹¹

“UANI who had successfully teamed up with U.S. lawmakers and pushed the European Union to force Belgium's Society of Worldwide Interbank Financial Telecommunication (SWIFT), to disconnect blacklisted Iranian banks from its network; is pushing for the Treasury, which itself has intensified its scrutiny of Lebanese banks in recent months, to issue a finding designating Lebanon's entire financial system as a money-laundering concern under section 311 of the Patriot Act. The U.S. issued such a finding against Iran's banking sector in November 2011, the first time it had been used against an entire jurisdiction since 2003.”⁹²

⁹¹ Paraszczyk, Joanna, “Lebanon concerned by Hezbollah money-laundering,” Jerusalem Post (August 13, 2012), see at <http://www.jpost.com>

⁹² The Daily Star, “U.S. group: Lebanese banks laundering money,” (July 07, 2012), see at <http://www.dailystar.com.lb> and Ed. the Wall Street Journal, “Activists Press Global Banks on Beirut,” (July 04, 2012), see at <http://blogs.wsj.com>

Even though Riyad Salameh, governor of *Banque du Liban*, has denied that any relationship between the latter and Iran exist; UANI argues that “despite Lebanon’s devastated economy, its currency and banking system operate as if they belonged within a more successful state. Lebanese sovereign debt to GDP ratio is the fourth highest in the world, yet the country’s sovereign bonds and credit default swaps trade at low yields, noting that the cost of Lebanese debt has decreased considerably since 2006, which coincides with increased sanctions pressure against Iran.”⁹³

“Unlike many other countries that sell Eurobonds and Treasury bills to foreign governments or financial institutions, Lebanon has kept its debt in-house, selling mostly to local banks or having the Central Bank itself buy up debt. According to the Central Bank, non-resident private sector deposits in local commercial banks have gone from just under \$10 billion at the end of May 2008 to over \$21.6 billion at the end of May 2012. According to stats from UANI, only 2.6 percent of Lebanon’s debt is held abroad. This, the group and others argue, raises questions.”⁹⁴

Where, exactly, are local banks getting the cash – particularly in the past four years – to buy all these bonds and bills?

The answer is largely unknown. Lebanon allows banking secrecy – meaning that only in a few circumstances are banks allowed to disclose information about their clients to authorities. Many, UANI among them, argue this opens Lebanon up to receive dirty money. For its part, the Central Bank says Lebanon is on the level, pointing to its Special Investigation Commission (SIC) tasked with keeping an eye on the financial sector and red-flagging potential money launderers.

“It is unclear how the U.S. will react. The Treasury Department has for years been doggedly pursuing both Iranian and Hezbollah money, and there is no indication it will stop. That said, the U.S. has many allies in Lebanon, and taking the full measures UANI is asking for would be an economic catastrophe for the country. Would the Obama administration throw Lebanon under the bus like that?”⁹⁵

⁹³ Ibid.

⁹⁴ “Flush with cash, Lebanese banks raise eyebrows,” July 9, 2012, see at <http://www.nowlebanon.com>

⁹⁵ Ibid.

Moving on to the next section, recent efforts to develop effective strategies for anti-money laundering and combating the financing of terrorism bring together several distinct but related aspects of financial systems and criminal law. Financial intelligence units (FIUs) constitute an important component of these strategies. Combating the crimes of money laundering and financing of terrorism is essential to the integrity of financial systems but, if these efforts are to be successful, traditional law-enforcement methods need to be supported by the contribution of the financial system itself. Financial institutions hold critical information on transactions that may conceal criminal schemes. Although this information is covered by secrecy laws, it has to be made available to law-enforcement agencies to enable them to trace criminal money channels.

In 1998, al-Madina Bank started to expand aggressively. With an absentee majority shareholder (Adnan Abou Ayash was living and working in Saudi Arabia) and an extravagant local helmsman, the bank started to drift into dangerous waters. The period 2001 and 2002 witnessed flagrant and profligate waste of financial resources, most often, associated with high profile purchases of real estate by members of the family of Rana Koleilat, particularly her brother Taha. By early 2002 it was obvious that al-Madina Bank was in serious trouble. The Governor of the Central Bank wanted to either apply strict measures to correct the situation or solicit a commitment by the owner regarding liabilities.

As of 1998, Adnan Abou Ayash made a number of transfers of funds to al-Madina Bank, either to the account of his brother Ibrahim or to his own account (no. 69911). It was later revealed that no such account number existed. In total, the transfers amounted to \$1.25 billion, yet in early 2003 the Banking Control Commission (BCC) estimated that both al-Madina Bank and its affiliate United Credit

Bank owed roughly \$465 million of which \$300 million were personally owed by Rana Koleilat, and \$133 million respectively. On the other hand, total facilities granted to regular clients by al-Madina and United Credit Bank was approximately \$56 million and \$17 million. It was obvious that normal commercial loans even if lost in total, were not the cause of lack of liquidity or accumulated losses, which exceeded \$1.25 billion of transfers. How could al-Madina and its affiliate lose so much money? In fact, the funds were not totally lost but grossly misused or misplaced. Assets that exceeded hundreds of millions of dollars were acquired for much higher than actual values, while Ibrahim Abou Ayash and Taha Koleilat spent money without consideration for value.

As of summer 2003, the Central Bank raised cases against Adnan Abou Ayash and Rana Koleilat and sought to secure assets that would cover defaulted debt. By early summer 2004, the al-Madina Bank's debacle had petered out; nevertheless, a number of issues and questions remain. First, how could an insignificant employee with the bank since 1984 become a moving force in two banks whose shares were owned by a successful businessman with dealings with the Saudi royal family? Second, numerous financial dealings would appear to suggest the Koleilats had strong ties with Syrian intelligence officers.

On the political spectrum, in late summer 2004, Security Council Resolution 1559 was passed calling on the Syrian government to withdraw its military and intelligence forces from Lebanon, and demilitarization of Palestinian factions supported by Syria in Lebanon, as well as Hezbollah. Syria's withdrawal was fulfilled by 26 April 2005 and thus enters Iran. At no time in recent history have Lebanon and Syria attracted as much international attention and action as after Hariri's

assassination and the United Nations Independent Investigation Commission (UNIIC) was established by Security Council Resolution 1595 in June 2005.

Consequently, both Patrick Fitzgerald, Deputy Commissioner of the Irish Police Force dispatched to Lebanon shortly after PM Rafiq Hariri's who for nearly three decades, from 1978 until his assassination on 14 February 2005, played a vital role in shaping the political and economic future of Lebanon, and Detlev Mehlis, Commissioner of the (UNIIC), indicated the need to study al-Madina bank accounts of which the findings are still to be incurred in full for possible links to the terrorist bombing that killed Hariri and twenty-two other civilians.

CHAPTER FOUR

FINANCIAL INTELLIGENCE UNIT

4.1 Introduction

The 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances can be seen as the starting point for the development of international anti-money laundering strategy by which criminals is be deprived from their economic resources and illicit proceeds of their crimes. Progress in this area has become a significant factor in the fight against money laundering, corruption, terrorist financing, and in protecting the integrity of the international financial system.

Since the law-enforcement agencies had restricted access to relevant financial information, generally due to banking secrecy laws or to incompetence in exchange of information mechanisms; AML strategies mandated states to engage the financial system in the effort to combat money laundering while, at the same time, seeking to ensure the retention of the conditions necessary for its efficient operation. Therefore, “the realization of the need for a system requiring disclosures of suspicious transactions on the part of financial institutions created the need for a central office or agency for assessing and processing these disclosures.”⁹⁶

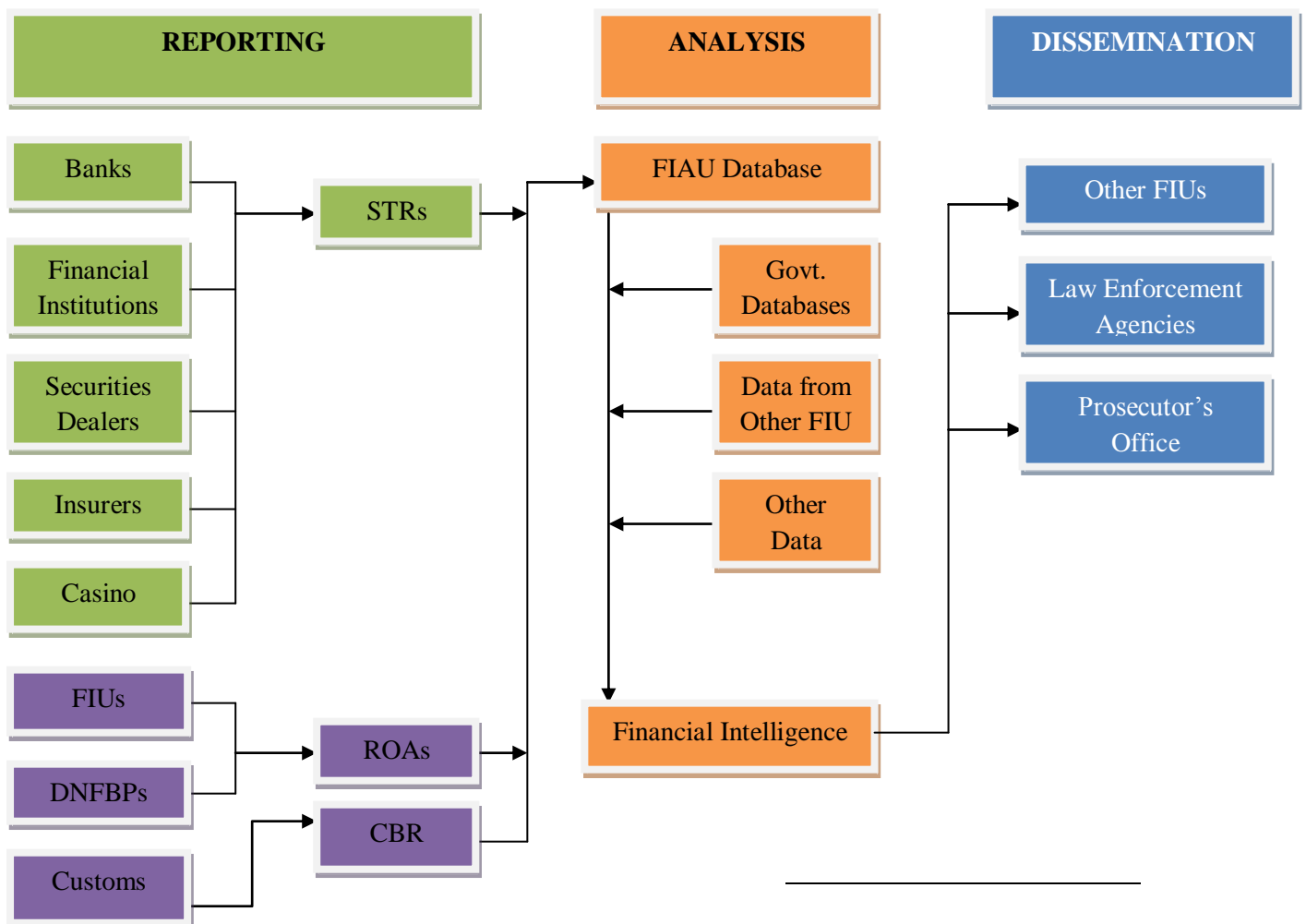
The very first few FIUs, established in the early 1990s, served as a central agency for receiving, analyzing, and disseminating financial information to combat money laundering. Over the following decade, the number of FIUs increased and the Egmont Group, the informal international association of FIUs, had 84 members in 2003. In that same year the FATF adopted a revised set of recommendations on

⁹⁶ International Monetary Fund, “Financial Intelligence Units: An Overview,” (Revised version of July 23, 2004), see at <http://www.imf.org/external/pubs/ft/FIU/fiu.pdf>

combating money laundering that, for the first time, explicitly called for the need to establish a functioning FIU. Later on, the International Monetary Fund and the World Bank, in addition to several member countries have provided technical assistance in establishing and strengthening of FIUs and expanding their responsibilities to include dealing with the financing of terrorism, in addition to money laundering and other serious offences.”⁹⁷

This chapter examines how the latest efforts to develop efficient strategies for anti-money laundering and combating the financing of terrorism has led to the founding of financial intelligence units that combine several diverse but unified elements of law enforcement.

4.2 Typical FIU Information Flow Chart



By definition, FIUs are “agencies that receive and analyze suspicious transaction reports and other reports from reporting financial institutions and other entities, and disseminate information to law authorities and foreign FIUs.”⁹⁸ Establishing an FIU is an integral factor of a country’s AML strategy that reflects the level of commitment to combating financial crime and adherence to international standards. It is optimal that FIUs be “customized to criminal standardized considerations specific to each country, and its basic features be consistent with the supervisory framework of the country, as well as with its legal and administrative systems and its financial and technical resources.”⁹⁹ While the political support is indispensable to guarantee its success, “all FIUs, as government agencies, must be granted the level of autonomy necessary to carry out its duties while being answerable for the results it achieves.”¹⁰⁰

4.3 International Confidence

International consideration for the FIU as a basic element of anti-money laundering strategy is very recent. In 1989, with the efforts of the FATF and international society, standards on combating money laundering were developed entailing the obligation of financial institutions to submit suspicious transaction reports to competent authorities that were recognized with the 1990 FATF Recommendations. Since these competent authorities were not defined, and could be any government agency for the purpose, it was only with the issuance of the 2003 Recommendations that the need for an FIU as defined by the Egmont Group was spelled out.

⁹⁸ Ibid.
⁹⁹ Ibid.
¹⁰⁰ Ibid.

4.3.1 The FATF 40+9 Recommendations

The 1990 FATF Recommendations designated competent authorities for receiving and dispensing suspicious transaction reports and referred indirectly to some of the functions and features that could be granted to such authorities of which receiving suspicious transactions reports (STRs) or cash transactions above a certain threshold; providing guidance to financial institutions; maintaining an automated database, compliance control and supervision/regulatory powers; and carrying out international cooperation. Other regulations governing suspicious transactions reports were also set out in the recommendations, such as the immunity of those who in good faith submit reports to the FIU and the general rule against tipping off.

The issuance of the revised FATF Recommendations in June 2003 was the turning point to the FATF's approach to the FIU as the central recipient of reports. Now, with the FIU openly recognized as one of the competent authorities, the recommendations state that "the FIU should have sufficient financial, human, and technical resources, and authorities should provide the widest possible range of international cooperation to counterparts and exchange of information should be permitted without unjustifiable restrictive conditions."¹⁰¹

4.3.2 The Egmont Group of Financial Intelligence Units

In 1995, Brussels, the Egmont Group of financial intelligence units was set up to support international cooperation and exchange of information. Countries had to go through a formal process in order to be recognized as operational FIUs that meet once a year and share administrative functions on a rotating basis. Since the Egmont Group is not an official institution, it has no stable secretariat. Besides its support position, Egmont's working groups, and the Egmont Committee are used to carry out regular

¹⁰¹ Ibid.

duties. Although all FIUs function differently, nearly everyone can exchange financial intelligence and other governmental data and public record information with foreign counterparts. One of the main goals of the Egmont Group is to create a global network by promoting international cooperation among FIUs.

4.3.3 The United Nations' International Conventions

In the last few years international conventions have recognized the vital role of FIUs and have provoked countries that are parties to these conventions to establish their own FIUs. The U.N. Convention for the Suppression of the Financing of Terrorism (1999), U.N. Convention against Transnational Organized Crime (2001), and U.N. Convention against Corruption (2003) call for, equally, the criminalization of the financing of terrorism; criminalization of association in international organized crime, corruption, money laundering, and obstruction of justice, and criminalization of all forms of corruption, money laundering, concealment of the proceeds of crime, and obstruction of justice. A common factor in the three conventions is that each calls for countries that are parties to criminalize money laundering and to adopt preventive measures that are, in large part, inspired by the FATF recommendations, and refer to the obligation to report suspicious transactions to competent authorities.

In the latest two conventions, referral to the FIU is explicit. For example, the United Nations Convention against Transnational Organized Crime calls for states to “ensure that administrative, regulatory, law-enforcement and other authorities dedicated to combating money-laundering ... have the ability to cooperate and exchange information at the national and international levels ... and to that end, shall consider the establishment of a financial intelligence unit to serve as a national centre

for the collection, analysis and dissemination of information regarding potential money laundering.”¹⁰²

4.3.4 Norms and Standards (EU Directives)

The European Union has taken large steps to “combat money laundering and international organized crime. The EU directives outline part of the legal framework for the fight against money laundering in the members of the European Union.”¹⁰³

The IMF goes on to specify that “since these directives are meant to be applied in countries with conflicting legal systems, they are of concern to countries who are not members of the European Union.”¹⁰⁴

Firstly, the Council Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering (91/308/EEC) included three basic principles: full cooperation of financial institutions with authorities responsible for combating money laundering, blocking suspicious transactions until the responsible authorities (FIU) had been notified; and furnishing information to the FIU whenever, as a consequence of an examination or otherwise, supervisors or regulators of financial institutions discover facts that could constitute evidence of money laundering. Secondly, the Directive of the European Parliament and the Council (2001/97/EC) amended the 1991 Directive and restated the key obligation of full cooperation and reporting of suspicious transactions set out in the previous and extends its reach beyond financial institutions to businesses and professions susceptible to money laundering.

¹⁰² Ibid.

¹⁰³ Ibid.

¹⁰⁴ Ibid.

4.4 Core Functions of an FIU

In general, FIUs have four major types: administrative-type, law-enforcement-type, judicial-type, and mixed or hybrid-type. However, such classifications, to a certain degree, are uninformed and that other ways of classifying FIUs are possible.”¹⁰⁵ FIUs have three core functions receiving, analyzing, and disseminating of information concerning money laundering and financing of terrorism. According to its type, in some countries, the FIU is assigned extra functions. For example, the Special Investigation Commission (the FIU of Lebanon) monitors the compliance of financial entities with AML/CFT regulations and standards and has the power to block reported suspicious accounts for a specified time. The FATF Recommendations set a standard that countries should establish an FIU with the three core functions and include other requirements that relate to the effectiveness of these three functions.

4.4.1 Who Must Report?

Unlike the 1990 FATF Recommendations that offered countries the “alternative of having a permissive or mandatory system intended for financial institutions to report suspicious transactions;”¹⁰⁶ the revised 2003 FATF Recommendations marked the expansion of the range of entities, beyond regulated financial institutions, subject to the reporting obligation. Moreover, countries were to consider setting up an extensive structure of reporting that would cover financial institutions and other non-regulated financial intermediaries, and to attend to risks of bureau de change.

In 1999, in Moscow, the *G8 Conference on Combating Transnational Organized Crime* “agreed on putting certain responsibilities, as appropriate, on those

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

professions such as lawyers, accountants, company formation agents, auditors, and other financial intermediaries who can either block or facilitate the entry of organized crime money into the global financial system.”¹⁰⁷

Building on the G8 *Gatekeeper* initiative, the 2003 FATF Recommendations extended basic prevention requirements, including the reporting obligation, with some qualifications, to a list of Designated Non-Financial Businesses and Professions (DNFBPs) including real estate agents; casinos; dealers in precious stones and metals; lawyers, notaries, and other independent professions and accountants in specific circumstances; and trust and company service providers.

4.4.2 Suspicious Activity/Transaction Reporting (SARs/STRs)

The 1990 FATF Recommendations stated that “countries should ensure that financial institutions monitor suspicious transactions; investigate their backgrounds; and keep their findings available for regulatory and law-enforcement authorities;”¹⁰⁸ though no requirement was set for them to report such to a specified competent authority. In fact, countries were encouraged to consider the feasibility and utility of a reporting system as it was not until the 1996 FATF Recommendations that suspicious transaction reporting was recognized as the international norm. In some countries, including the U.S., the obligation to report involves suspicious activities rather than suspicious transactions; whereas “the connotation of the former is broader than the latter, since it includes suspicious transactions and other circumstances that raise suspicions of criminal activities.”¹⁰⁹

The 2003 Recommendations leave to each country the decision to ascertain the degree of suspicion needed to trigger the reporting obligation. Recommendation

¹⁰⁷ Ibid.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid.

13 refers to a “financial institution that suspects or has reasonable grounds to suspect that funds are related to criminal activity.”¹¹⁰ Though the approach of reporting obligation varies from country to country, the fact remains that financial institutions and other reporting entities subject to the Know-Your-Customer (KYC) standards are in the best position to detect suspicious or unusual transactions.

The main aim of reporting is to provide the FIU with information on transactions involving funds that could stem from criminal activity. In reality, however, the range of criminal offenses that constitutes criminal activity – and thus constitutes an obligation to report a transaction to which they are related – varies from country to country.

The 2003 Recommendations attempted to provide further guidance in that respect. Recommendation 13 and its Interpretative Note define the standard for reporting with respect to categories of predicate offenses for criminalization of money laundering set out in Recommendation 1. It states that “countries should apply the crime of money laundering to all serious offenses, with a view to including the widest possible range of predicate offenses. The standard for criminalization, in turn, refers to the Vienna (1988) and Palermo (2000) Conventions.”¹¹¹

Whereas The Vienna Convention listed only drug-related offenses as predicate offenses, the Palermo Convention set out the norm that “predicate offenses should include the widest range of predicate offenses and all serious crimes, which the Convention defines as conduct constituting an offense punishable by imprisonment for a period of at least four years.”¹¹²

With the issuance of the FATF Nine Special Recommendations on Counter-Financing of Terrorism in October 2001, most countries amended their respective

¹¹⁰ Ibid.

¹¹¹ Ibid.

¹¹² Ibid.

laws requiring that concerned entities report transactions suspected of being related to terrorism. Unlike money laundering transactions, terrorist financing transactions are illegal not because of the criminal origin of the funds, but in view of the criminal intent with which they are carried out.

4.5 Exchange of Information with Other FIUs

One of the most important functions of an FIU is unhindered exchange of information with counterpart FIUs. Recommendation 40 states that “countries should ensure that their competent authorities provide the widest possible range of international cooperation to their foreign counterparts... Where the ability to obtain information sought by a foreign competent authority is not within the mandate of its counterpart, countries are also encouraged to permit a prompt and constructive exchange of information with non-counterparts.”¹¹³

Exchange of information among FIUs is laid down in the Egmont Group Principles for Information Exchange between Financial Intelligence Units for Money Laundering Cases and, further, in the Group’s best practices for the Implementation of Exchange of Information between FIUs. Egmont states that “information exchange among FIUs should be provided upon request or voluntarily for the sole purpose for which the information was requested or provided, and may not be disclosed to a third party or for the use as evidence in judicial proceedings without the prior consent of the disclosing FIU and in absolute confidentiality.”¹¹⁴

4.6 FATF Mutual Evaluation of Financial Intelligence Units

Starting 1992, assessments of AML/CFT systems including FIUs have been carried out since the first round of mutual evaluations of FATF members and in the

¹¹³ Ibid.

¹¹⁴ Ibid.

1996 Recommendations, FIUs were included in the expression competent authorities. With the endorsement of the revised FATF Recommendations and the FATF Methodology for Assessing Compliance with AML/CFT Standards by almost all institutions in 2003 and 2002 respectively, the assessments carried out included explicit mention of FIUs, although this was not yet officially a constituent of the international standard.

Over the years, the FATF recommendations have been increasingly recognized as the universal standards for AML/CFT. In March 2004, “the Executive Boards of the IMF and the World Bank unconditionally endorsed the 2003 FATF Recommendations as the new standard in their work, in concert with a revised methodology to assess the new standards. Therefore, AML/CFT is now a permanent element of the international organizations’ work.”¹¹⁵

4.7 Looking Ahead

In general, among others, “the IMF has identified five challenges that appear as constants in the structure of FIUs and the development of existing ones.”¹¹⁶ The first is that “there is no set recipe to put together an FIU. Each FIU must be tailored to the specific conditions of the country in which it is placed.”¹¹⁷ All interested parties agree that factors such as the structure and relative weight of financial crime in the country, the political intent for combating such crime, the resources needed for the task and the legal and administrative systems all have to be taken into consideration in developing an FIU or suggesting procedures to improve the performance of an existing one.

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Ibid.

The second challenge is, paradoxically, change. In several countries that have established FIUs over the past ten years or so, change has been evident, with their FIUs having had to launch as reliable associations competent in dealing with financial institutions and other reporting entities, other government agencies, and international counterparts, changing conventional interactions amid financial institutions and law-enforcement authorities in the course.

The third challenge facing FIUs is the integration of terrorist financing in their work, in addition to the expansion of the suspicious transaction reporting obligation beyond the regulated financial sector, and the quest for enhanced international cooperation. The inclusion of combating the financing of terrorism to the scope of the FIU's functions presents special challenges. As noted earlier, terrorism is, in many ways, different from money laundering. Terrorism is usually not considered a profit-motivated crime; and despite large amounts of funds may be drawn in the commission of terrorist acts, the purpose of depriving criminals of the proceeds of their illegal activity, which is at the heart of an anti-money laundering strategy, does not apply directly to terrorism.

The fourth challenge faced by FIUs is that widening the scope of the reporting obligation beyond the regulated financial sector to include casinos; dealers in high-value goods; and, more recently, the accounting and legal professions has had several implications for FIUs. Countries acknowledge that substantial outreach resources are likely to be needed to bring such professions into compliance with the reporting requirements.

The fifth challenge compels FIUs to be gradually more involved in international cooperation. The extensive development of FIUs over the last fifteen years has been accompanied by an influential growth in international cooperation

between FIUs. Despite the progress achieved to date, significant challenges lie ahead, above all, removing legal obstacles that hinder information sharing and developing and improving systems to ensure the confidentiality of exchanged information.

This chapter has attempted to summarize several topics under the general heading of what a financial intelligence unit is. Of the main points discussed is the objective of engaging the international society with its different and contradicting components to the fight against money laundering and the more compelling terrorist financing. Add to that the support of consenting states to the FATF's global anti-money laundering and counter-financing of terrorism strategy that would address the rising issues related to threats emanating from the financing of proliferation of weapons of mass destruction which is best dealt with through the consistent implementation of the U.N. targeted financial sanctions when these are called for. Improved transparency is vital to make it harder for criminals and terrorists alike to conceal their identities or hide their assets behind legal persons and arrangements and, in particular, when dealing with Politically Exposed Persons (PEPs) that require stronger requirements through expanding the scope of money laundering predicate offenses to include corruption and tax evasion. For that matter, governments are urged to provide better operational tools and a wider range of powers and resources, both for the financial intelligence units, and for law enforcement to investigate and prosecute money laundering and terrorist financing.

For their part, the financial systems are expected to utilize an enhanced risk-based approach which enables countries and the private sector to apply their resources more efficiently by focusing on higher risk sectors where the level of mitigation applied is commensurate to the level of risk identified. More importantly is, the FATF's call for a more effective international co-operation including exchange of

information among relevant authorities, conduct of investigations, and tracing, freezing and confiscation of illegal assets. The thesis now moves to the next chapter dealing with Lebanon's financial system, its anti-money laundering and counter-financing of terrorism regime and the role of the Central Bank of Lebanon in the last financial markets' crisis.

CHAPTER FIVE

LEBANON'S ANTI-MONEY LAUNDERING AND COUNTER-FINANCING OF TERRORISM REGIME

5.1 Introduction

Lebanon's experience, drawing on past financial crises of the 1960s to the most recent financial markets crisis and the economy's responses to different systemic crises and exceptional policies by the Central Bank, has proven best case scenario of a resilient Lebanese economy. The Central Bank's policy of maintaining an exchange rate peg to the U.S. dollar has proven indispensable in sustaining financial stability in hard times without compromising competitiveness and prosperity.

At present,

“foreign reserves held by the Central Bank pooled with the banking sector's liquidity surplus appear sufficient to meet short-term pressures on the exchange rate. In the long run, however, monetary policies have to be geared to sustain the current exchange rate peg to the U.S. dollar.”¹¹⁸

Therefore, it is possible to

“emphasize not only best practices of the Lebanese decision-makers, but also expose a modern theory of liberal democratic market system that might shed some light on our understanding of banking soundness and prudential policy.”¹¹⁹

Lebanon's resolve has proven resilient despite the ensuing international pressures in a highly volatile political milieu. Prior to the international financial markets crisis, the long political impasse, the assassination of former Prime Minister

¹¹⁸ International Monetary Fund, Lebanon: 2007 Article IV Consultation Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director of Lebanon (December 2007) see at <http://www.imf.org/external/pubs/ft/scr/2007/cr07382.pdf>

¹¹⁹ Barazy, Ma'an, *The Behavior of Lebanese Markets in Time of Crisis (1960-2009): The Lender of First Resort*, Data Invest Arabia INC, Policy and Research Papers (Vol.2, 1st ed., pp.14-16, 2009).

Rafiq Hariri (2005) and the July War (2006), the coordinated efforts of the Central Bank and financial sector to restore confidence has resulted in avoiding any devaluation of the Lebanese pound and risk of the financial system becoming illiquid helped by an ever willing domestic political consensual solidarity. Yet is such a coordinated and well-handled crisis management the result of concerted efforts of all or is it because former Lebanese militia landlords have all their interests vested in the financial sector?

Regardless of the answer, the rejuvenation of Lebanon's credit standing in international financial markets, as well as that of its financial sector, depends on attainable yet un-sustainable political stability in the country. Lebanon is one of the most important banking and financial centers in the Middle East. The economy is mainly dependent on the provision of services where the Banking Secrecy law applied therein along with a relatively liberalized banking sector has attracted important capitals mostly cultivated by the Arab world and the region's financial market growth.

This chapter provides a thorough overview of the Lebanese financial system with special focus on the role of the Central Bank and banking sector in developing timely responses to different systemic crises. It seeks to underline not only best practices of the Lebanese law-makers but also expose banking soundness and prudential oversight by all stakeholders through analytical discourse of Lebanon's anti-money laundering and counter-terrorist financing regime in compliance with the international standards.

5.2 The Lebanese Financial System

Throughout 2007, "the U.S. subprime mortgage markets melted down and global money markets were under tremendous pressures. The U.S. subprime mortgage crisis manifested itself first through liquidity issues in the banking system owing to a

sharp decline in demand for asset-backed securities.”¹²⁰ Hard-to-value structured products and other instruments created during a boom of financial innovation had to be severely marked down due to the newly implemented fair value accounting and credit rating downgrades. Credit losses and asset write-downs got even worse with declining housing prices and accelerating mortgage foreclosures which increased in late 2006 and worsened further in 2007 and 2008.

As a 2012 Brookings study makes clear: “what is exceptional about this crisis is that severe financial problems have emerged concurrently in many countries, while its economic impact had been felt globally due to the increased interconnectedness of world markets.”¹²¹ The world has gone through its greatest financial crisis since the collapse of the U.S. banking system in 1929. Yet, the crisis has had limited effect on Lebanon’s financial system which, despite its political imbalances, had shown great resilience basically lain by the system’s proficiency to similar situations stemming back to the civil war period.

Lebanon has focused on conservative treatment of deposits, market discipline and strong supervision but also on retaining the open policy of interest rates practiced since the 1990s. These elements, combined with quantitative and qualitative high levels of regulatory laws and by-laws of the Central Bank, the predominance of the family-led-banking business, and regulations that prohibit investing in structured and complex products have all contributed to Lebanon not being affected by the global financial crisis.

¹²⁰ Laeven, Luc and Valencia, Fabien, “Systemic Banking Crisis: A New Database,” (Nov. 2008) see at http://www.management.wharton.upenn.edu/gullin/2008_docs/Laeven_Valencia_intl_banking_crisis_2008.pdf

¹²¹ Associazione Luiss-Guido Carli and Fondazione Cesifin (2012), see at http://www.brookings.edu/~media/Files/rc/papers/2009/0928_modelling_mckibbins/0928_modelling_mckibbin_stoeckel.pdf

Lebanon's free market economy, the absence of controls on movement of capital and foreign exchange, highly sophisticated labor force, good quality of life, and limited restrictions on investment have lured foreign businesses to set up offices in recent years. However, the country's political and security environment may affect foreign investment in the long run. The political situation is delicate, and tensions could escalate before any constitutional upturn. In addition, a number of issues continue to cause frustration among local and foreign investors that include red tape and corruption, arbitrary licensing decisions, hard customs procedures, archaic legislation, an incompetent legal system, high taxes and fees, elastic interpretation of laws, and frail enforcement of intellectual property rights.

“Lebanon is one of the few countries that has benefited from the global financial crisis. There was a significant increase in capital inflows mainly from the Lebanese Diaspora that perceived Lebanon's banking sector as relatively safe given its high liquidity and high interest rates on deposits.”¹²²

As the International Monetary Fund has recently noted, “Lebanon benefits first and foremost from a perceived implicit guarantee from donors, but also from its reputation in credit markets and its unique investor base. Investors and depositors alike take comfort from the discernment that donors have signaled an implicit guarantee not to let Lebanon default and the fact that Lebanon has never defaulted on its external debt obligations in the past.”¹²³ Local banks, which hold the majority of government paper, are an important pillar of stability, since their large exposure to sovereign debt creates strong incentives to stay the course, even through times of financial pressures.

¹²² U.S. & Foreign Commercial Service and U.S. Department of State, “Doing Business in Lebanon: 2009 Country Commercial Guide for U.S. Companies,” see at <http://lebanon.usembassy.gov/root/pdfs/finalccg2009.doc>

¹²³ Pfennig, Axel Schimmel and Gardner, Edward H., International Monetary Fund, “Lebanon: Weathering the Perfect Storms,” see at <http://www.imf.org/external/pubs/ft/wp/2008/wp0817.pdf>

In June 2006, “the IMF held a broad discussion of the concept of stability and resilience to fathom the development of macroeconomic vulnerabilities in Lebanon. It found that the solvency of the state and the high mutual exposure between the government and the domestic banking system remain the key vulnerability (distress in one of these sectors would rapidly be transmitted to the other one.)”¹²⁴

Remarkably, “twenty-seven percent of the Lebanese banks’ assets are in treasury bills, that is approximately sixty percent of total credit is owned by local banks which is, by international standards, very high.”¹²⁵ Whereas banks remain the primary source for the government’s financing needs, the ensuing interdependence of the government, Central Bank, and commercial banks has created incentives for all actors to behave in a concerted way to preserve financial stability.

Economic functionality and the high performance of the Lebanese banking sector has played a major role in financing the structural current account deficit of the Lebanese economy. Since 1997, a large number of banks subscribed in the Eurobonds of the Lebanese Government allowing the Central Bank to replenish its foreign reserves repeatedly and to protect its monetary policy of fixed exchange rate that could have been attainable otherwise.

“Such financing attracted deposits and increased lending resulting in a significant growth that was able to maintain effective contact with, if not control over, the increasing amounts of money the Lebanese (mainly expatriates) succeeded in gathering thereby preventing the country from tackling significantly the international financial markets and avoiding its exposure to foreign debt risks.”¹²⁶

¹²⁴ Barazy, Ma’an, “the Behavior of Lebanese Markets in Time of Crisis (1960-2009): The Lender of First Resort,” (Data Invest Arabia INC, Policy and Research Papers, vol.2, 1st ed., 2009): pp. 43-45.

¹²⁵ Chaaban, Jad and Dhillon, Navtej, “Global Economic Crisis: Prosperity and Politics in Lebanon,” (Brookings May 2009) see at http://www.brookings.edu/interviews/2009/0504_Lebanon_dhillon.aspx

¹²⁶ Nahas, Charbel, “The Lebanese Financial Sector: its economic function, its risks and its potential,” (November 2000), see at http://www.charbelnahas.org/textes/Ecrits_sur_l'economie/Economic_function_of_the_Lebanese_banking_sector.pdf

5.3 The International Monetary Fund Mission to Lebanon

In March 2009 the IMF declared that “Lebanon has shown remarkable strength in face of the unfolding global financial crisis. The financial system has had virtually no direct exposure to distressed financial products or markets and remained highly liquid, while economy continued to show considerable resilience.”¹²⁷

Despite the large fiscal and external vulnerabilities related to the sheer size of sovereign debt and government financing needs, prudent macroeconomic and good governance have strengthened the economy’s ability to ride out external shocks. Such policies helped maintain fiscal primary surpluses, a cautious interest rate policy, and strict oversight of the financial system. The primary surpluses have contributed in lowering the debt-to-GDP ratio by approximately 20 percentage points since 2006; an improvement toward fiscal consolidation. Authorities have maintained interest rates at appropriate levels to maintain ongoing deposit inflows, rapid de-dollarization, and strengthening of the external position.

“Strict financial oversight has safeguarded the banking sector from exposure to troubled international banks, structured products and wholesale financial markets. Such policies helped maintain confidence in the financial system in particular and the Lebanese economy as a whole, allowing for a steep build-up of international reserves, even during the global financial crisis.”¹²⁸

“The IMF has adamantly supported these policies through a quarterly monitoring framework and two drawings under the December 2008 – June 2009 Emergency Post-Conflict Assistance (EPCA) program, underscoring the program’s efficiency as a supporting tool for the authorities’ success in guarding macroeconomic and financial discipline in the ever more challenging external environment while the deep global recession and the dysfunctional international credit markets make it even more urgent for Lebanon to address its underlying vulnerabilities, mainly its very high level of public debt.”¹²⁹

¹²⁷ International Monetary Fund, “Lebanon-2009 Article IV Consultation Mission, Mission Concluding Statement,” (5 March, 2009) see at <http://imf.org/external/np/ms/2009/030509.htm>

¹²⁸ Ibid.

¹²⁹ Ibid.

5.4 Lebanon's AML/CFT Regime

With the lack of meaningful statistics concerning the size of money laundering in Lebanon, authorities deem the major sources of illicit funds as resulting from criminal activities committed mostly abroad.

Lebanon has been always a financial hub for banking activities in the Middle East and has had one of the most sophisticated banking sectors in the region. Nevertheless, "Lebanon faces significant money laundering and terrorist financing concerns related, for most but not least, to alternative drug trade and poor control of the cross-border cash transport."¹³⁰ It is worth mentioning that "Lebanon enjoys a considerable inflow of remittances from expatriates (estimated at \$7 billion in 2009); though, a number of Lebanese abroad are considered to be involved in underground business and trade-based money laundering (TBML) activities."¹³¹ Still, local authorities fail to recognize the money laundering methods and techniques that are generally used in the country.

Regarding terrorism, two major terrorist acts were of great significance: the assassination of prominent Lebanese PM Rafic Hariri (2005) and the Nahr al-Bared terrorist attacks against the Lebanese Army (2008). It is clear that organized terrorism has a ripe ground in Lebanon, also financing sources that sustain these groups either locally or from abroad. However, the Lebanese authorities assume that the financing process is ambiguous and that it is generated outside Lebanon. In terms of combating terrorist financing and adjunct risks, no records are available; nevertheless, it is feared that such risks exist considering the attacks that have occurred during the last years.

¹³⁰ International Narcotics Control Strategy Report – US Department of State, "Money Laundering and Financial Crimes," vol. 2, (Mar. 2010) see at <http://www.state.gov/documents/organization/137429.pdf>

¹³¹ Ibid.

Throughout 2010, “the SIC investigated 179 cases of money laundering offenses and terrorist financing acts. Although the number of cases investigated has steadily increased from 116 cases in 2009, judicial proceedings, prosecutions and convictions in that regard are still lacking.”¹³²

In addition to the names of suspected terrorist individuals and terrorist groups on the UN 1267 Sanctions Committee’s Consolidated List, the SIC circulates, through the financial sector, a list of the U.S. Government’s Specially Designated Global Terrorists (SDGT), as well as entities designated by the European Union under its relevant authorities. On the other hand, “Lebanese law-makers should consider amendments to legislation to allow for extra forfeiture cooperation internationally and also provide a mechanism for returning of fraudulent proceeds.”¹³³

The INCSR went on to say that “it is indispensable that the Lebanese legislature approve a mandate concerning the enactment of a capable cross-border cash declaration or disclosure system. One of the vulnerabilities of supervisory and regulatory authorities is the trading of bearer shares of unlisted companies as well as the absence of measures to criminalize tipping off. Moreover, the law authorities should emphasize linking predicate offenses to money laundering crimes. The SIC’s reliance on suspicious transactions reports filed by financial institutions to initiate investigations is a shortcoming. Safeguards at hand do not adequately address to the issue of Blood Diamond money laundering and value transfers through Lebanon or by traders overseas. Law enforcement authorities should examine domestic ties to the international network of Lebanese brokers and traders who are generally involved in underground finance, trade fraud, and trade-based money laundering activities.”¹³⁴

It is also essential that the Lebanese Customs inform the SIC of trade-based money laundering or terrorist financing suspicions; though, high levels of corruption within Customs, the report added, prevent the required inter-agency cooperation and make possible money laundering and terrorist financing risks. Then again, “Lebanon

¹³² 2010 Annual Report, Special Investigation Commission. See at <http://www.sic.gov.lb/publications>

¹³³ Ibid.

¹³⁴ Ibid.

should also consider joining the U.N. Convention for the Suppression of the Financing of Terrorism.”¹³⁵

5.4.1 Special Investigation Commission / Institutional Framework of AML/CFT

Yet Lebanon has taken huge steps concerning the safety of the financial sector setting up sound preventive measures against money laundering and terrorist financing risks. By virtue of the Law No. 318 of April 20, 2001, the SIC was established. Its mandate is to investigate operations suspected of being related to money laundering crimes and the financing of terrorist acts. The SIC monitors the applicability and implementation of anti-money laundering policies and procedures and ensures that the financial sector is in compliance with the respective laws, circulars and guidelines of regulatory and supervisory bodies as well as its adherence to international standards recognized through the FATF 40 Recommendations, EU Directives, and associated best practices.

5.4.2 Approach Concerning Risk

Lebanon did not previously evaluate risks related to money laundering and terrorist financing activities in the financial sector and non-financial sector such as the Designated Non-Financial Businesses and Professions. However, frequent and timely amendments to law 318 by the Central Bank including amendments to the anti-money laundering system controlling the financial and banking operations required that banks and credit institutions adopt Risk-Based Approach for classifying customers and transactions. Such amendments rely on the FATF’s Risk-Based Approach, due diligence measures for verifying customers’ identities; and include guidelines to extract customer’s risks, assess both geographical regions and services rendered as

¹³⁵ Ibid.

well as establishing proper procedures for corporeal control of high-risk customers and transactions.

5.4.3 Progress Achieved

Prior to the AML law 318 and owing to the lack of basic legislation for anti-money laundering and counter-financing of terrorism in addition to strong legal provisions protecting the banking secrecy law of 1956, Lebanon was listed on the FATF's list of Non-Cooperative Countries and Territories (NCCT) in June 2000. On 20 April 2001, the Cabinet passed the AML Law No. 318 and, accordingly, the SIC was established. The provisions of the law 318 included a definition of the crime of money laundering and sanctions imposed on its authors, and it exclusively granted the SIC the powers to lift the banking secrecy.

As a result, Lebanon was de-listed from the NCCT in June 2002. Thereafter, major developments took place including the affiliation of the SIC to the Egmont Group of Financial Intelligence Units in July 2003; Lebanon's membership to the Middle East and North Africa Financial Action Task Force (MENAFATF) as well as its main role to create the latter as a FATF Style Regional Body (FSRB) at an inaugural Ministerial Meeting held in Bahrain in November 2004. The formation of the MENAFATF has made possible information exchange among member countries and, more importantly, has provided the technical support needed as well as assistance from international organizations such as the World Bank and IMF to regional countries.

5.5 Mutual Evaluation of Lebanon's AML/CFT Regime

The evaluation of the anti-money laundering and terrorist financing regime was based on the FATF's 40+9 Recommendations using the AML/CFT Methodology

of 2004. It covered the laws, regulations and other materials provided by Lebanon, as well as information obtained by the evaluation team during its on-site visit to Lebanon from 9 to 20 February 2009. During their mission, assessors reviewed the AML/CFT institutional framework, relevant laws, regulations, guidelines and requirements, and other AML/CFT measures applied through financial institutions and DNFBPs.

5.5.1 Legal Systems and Related Institutional Measures

Lebanese law criminalized the act of money laundering by virtue of the Law No. 318 of 2001 that was later amended in 2003. Criminalization was adherent to both the Vienna and Palermo Conventions regarding the material elements of crime. As for the mental part, the law specifically required the existence of knowledge factor in all forms of laundering except for concealing or providing false disclosures considering that the knowledge element can be inferred from the material act itself. Lebanon opted for the list of crimes approach but non-inclusive of all of the 20 crimes described in the FATF Methodology.

The AML/CFT Law sanctions anyone who commits or contributes or participates in money laundering operations, but criminalization of attempted money laundering is not there. While legal entities shall be held punishable for criminal liability, sanctions for natural and legal entities are sound and proportionate according to international best practices. The effectiveness of sanctions imposed could not be assessed in the absence of statistical data; even though a number of convictions were issued in a number of money laundering cases.

With regard to terrorist financing, Lebanese legislation has criminalized the act of financing of terrorism by virtue of the Law 553/2003. However, the definition was ambiguous as to what the financing act should include such as providing or collecting funds, as well as the act of terrorism financing does not cover terrorist

organizations and activities. Moreover, there is no indication whether the funds might be originating from legal or illegal sources. Each and every one of the accomplice, the instigator and anyone involved in the crime of terrorism financing shall be punished and the attempt at terrorist financing as well. According to the FATF Recommendation 17, sanctions imposed against natural and legal persons should be reasonable and proportionate.

The crime of terrorist financing is a predicate offence of money laundering; yet, as a separate crime, it does not cover all elements of a predicate offence as required by the U.N. Convention for the Suppression of the Financing of Terrorism. On the other hand, the crime of terrorist financing is not valid if the act was financed overseas. Still, effective measures for counter-financing of terrorism cannot be assessed in the absence of reliable statistics.

Both the Lebanese Penal Code and Law 318 include specific texts concerning the confiscation of funds and proceeds of crime while resting the burden of proof with the indicted. By rendering a final ruling in any crime of the predicate offences, the funds and proceeds of crimes shall be confiscated in favor of the state and the indicted shall have to prove the legitimate source of such funds or otherwise. It is worth mentioning that the effectiveness of confiscation arrangement was not assessed since no statistics were available for the evaluation team at the time of the assessment.

5.5.2 Preventive Measures: Financial Institutions

In addition to the Law 318, the Central Bank's System of Controlling Financial and Banking Transactions is well thought-out secondary legislation. The Law and relevant circulars cover AML requirements such as the identification and verification of clients and beneficial owners as well as Customer Due Diligence (CDD). Although a high threshold was set for transactions involving life insurance

premiums; financial intermediaries, finance lease, insurance and exchange companies has no obligation to apply the same to infrequent transactions or those suspected of being related to money laundering, or where identification or information obtained of the legal position of persons, legal persons or arrangements are insufficient or inaccurate.

It was established that requirements should be extended to financial institutions so as to identify and verify ownership and control structure of legal entities specifically where legal texts authorize the issuance of bearer shares, and to identify the natural person who has full ownership or control over the legal entity. Due diligence requires information obtained should include the purpose and type of business relationship, and when high risk customers or businesses; Enhanced Due Diligence (EDD) procedures also apply. Financial institutions should abide by their reporting obligations where due diligence measures for clients and beneficial owners cannot be realized.

Financial institutions are not bound by law for management to identify whether a customer or a Beneficial Right Owner (BRO) is a Politically Exposed Person (PEP). There are no sufficient policies and procedures to prohibit the misuse of technology. The scope of obligations involving dealings with correspondent banking as well as non face-to-face business transactions is limited. With regard to reliance on third parties, there are limited obligations in place for banks and credit institutions since they lack required measures to identify non-resident customers as well as the absence of warning system for countries and territories that are non-compliant with the FATF.

Lebanon has held firmly to a banking secrecy system by virtue of the Banking Secrecy Law of 1956; yet, Law 318 explicitly grants the SIC the exclusive right to lift

the banking secrecy in cases suspected of being related to money laundering and in exchange of information with foreign counterparts. Regarding electronic transfers, the Central Bank's decree of 2005 included the requirements of Special Recommendation VII with respect to the need to establish information about the originator of transfer. With respect to record keeping and wire transfer obligations, there are provisions binding banks and intermediary credit institutions to keep records of transactions for a period of five years. Money dealers of Category A should implement an effective risk-based approach to adequately identify transfers with missing information; however, a high threshold of \$10,000 is set for wire transfers that need customer identification.

Banks and credit institutions are asked to update files, transactions and businesses, except for the requirement to keep records of unusual transaction reports for a period of five years. There is no similar commitment for financial intermediaries, finance lease, insurance and exchange companies to monitor unusual transactions. Financial institutions shall be required to abide by the necessary measures regarding business relationships and transactions with customers (including legal persons and other financial institutions) in countries that do not or insufficiently apply the FATF Recommendations. It is necessary to have effective control measures that ensure that financial institutions are aware of ML/FT risks and correspondent anti-measures in other countries and transactions or businesses that do not have an apparent or visible economic or lawful purpose as well.

Law 318 further stipulates that financial institutions are required to submit Suspicious Transactions Reports (STRs) to the SIC; yet, the definition of illicit funds does not include the proceeds of 20 predicate offenses mentioned in the methodology. Moreover, financial institutions are not required to report transactions suspected of

being related to the financing of terrorism including reporting of attempts of money laundering. In light of the low number of reported cases, or absence on part of the remaining institutions, the competency and efficiency of financial institutions is inadequate with respect to AML/CFT international standards.

Not all institutions subject to Law 318, their directors, officers and employees have legal protection against criminal and civil liabilities when disclosing information or reporting concerns to the SIC. On the other hand, the SIC is responsible for raising awareness, providing training on real-life cases, issuing annual reports; as well as providing feedback to the reporting entities. It is worth mentioning that there is no reporting system for cash transactions that exceed a designated threshold. Instead, a Cash Transaction Slip (CTS) is collected and kept upon deposit of cash or when the total of several deposits on a single day exceeds the designated threshold of \$10,000 or its equivalent in other currencies indicating the amount, source and object of funds as well as the beneficial right owner.

Moreover, not all financial institutions (excluding banks and credit institutions) are required to set an operating manual including policies, procedures, and internal controls for their AML/CFT programs. Arrangements for setting up a compliance unit include designation of a full-time compliance officer and establishing an independent audit function, while providing for an ongoing staff training program and screening of new employees. Not all institutions are required to ask their subsidiaries and branches abroad to apply AML/CFT measures when dealing with countries that do not apply or insufficiently apply the FATF Recommendations.

The Central Bank has set up special procedures to ensure that no shell banks are established. While banks and credit institutions were bound to verify the identity and activities of their correspondent banks, and that they effectually exist according to

official identification documents obtained; other financial institutions that might deal with correspondent banks were not obliged to verify that their correspondents are not dealing with shell banks. Besides, there are no texts providing for the implementation of administrative sanctions against institutions violating the Law 318.

5.5.3 National and International Cooperation

Both the National Coordination Committee for Anti-Money Laundering and the National Coordination Committee for the Suppression of the Financing of Terrorism were set up for the sole purpose of increasing interagency cooperation. The principle for mutual legal assistance is judicial cooperation based on agreements; and where no such agreements exist, Lebanon shall adopt the principle of reciprocity. However, agreements of that sort are not applicable in the case of terrorist financing; for they are subject to the general rules in effect for the request of assistance related to other crimes. Besides, the SIC can request information from foreign counterparts, judicial, supervisory, and law enforcement authorities and vice versa. Information exchange is conducted through mutual legal assistance treaties and judicial cooperation between competent authorities while at other times through the Egmont secured web-mail.

In relation to the extradition law, Lebanon is highly cooperative in assisting and overcoming any legal obstacles where the requestor criminalizes the principle act of crime. Lebanese citizen shall not be extradited but brought before the local courts. Individuals who commit the crime of money laundering and terrorist financing shall be extradited according to the requests of their extradition and shall be subject to the same rules imposed on persons who have committed all types of crimes, unless a special agreement is signed between Lebanon and the country regarding the crime of money laundering and terrorist financing in particular. It is worth mentioning that the

money laundering crime does not encompass all underlying crimes; hence, affecting the ability of the country to offer full international cooperation in this regard. No case of extradition was reported whatsoever and there are no procedures or arrangements for the seizure and confiscation of assets with other countries. Lebanon has not yet considered the possibility of establishing a fund for confiscated assets as well.

We now turn to the last section of this chapter showing how, in early 2012, the U.S. Treasury Department's designation of a number of Lebanese citizens as drug kingpins and terrorists for allegedly working as part of a South American money-laundering and drug-trafficking cartel with links to Hezbollah has turned into one of the worst nightmares for Lebanese banks. In early 2011, the Lebanese Canadian Bank was designated as a financial institution of primary money laundering concern for its part in transferring funds and assets for drug-traffickers in South America, the Middle East, Europe and Africa and laundering as much as \$200 million every month through cash smuggling and Lebanese businesses as well as for financing Hezbollah.

As a matter of fact, "the Treasury Department has designated more than 1,100 people as kingpins. The 1999 act freezes and allows the government to seize all property and assets of the designated person that are under U.S. authority. Penalties for violations if captured and deemed guilty include up to ten years in prison and fines. Being designated as a global terrorist by the U.S. Government freezes a person's assets and prohibits dealings with them."¹³⁶

5.6 The Lebanese Canadian Bank

Section 311 of the Patriot Act

"authorizes the Secretary of the Treasury, upon finding that reasonable grounds exist for concluding that a foreign jurisdiction, institution, class of transaction, or type of account is of primary money laundering concern, to require domestic financial institutions to take certain special measures against the targeted primary money laundering concern... and to bring additional pressure on those jurisdictions and institutions that pose money laundering threats. Through the imposition of certain special measures, more information can be obtained about the targeted jurisdictions, institutions, transactions, or

¹³⁶ *The Daily Star*, "U.S. names Lebanese in Hezbollah drug ring," 07 July 2012, see at <http://www.dailystar.com.lb>

accounts; or can prohibit U.S. financial institutions to involve with jurisdictions, institutions, transactions, or accounts of money laundering concern.”¹³⁷

On February 17, 2011, the Secretary of the Treasury, in consultations with relevant Federal agencies and departments, and after consideration of the factors enumerated in section 311, through his delegate, the Director of the Financial Crimes Enforcement Network (FinCEN), established that “reasonable grounds exist to proclaim that the Lebanese Canadian Bank SAL (LCB) is a financial institution of primary money laundering concern.”¹³⁸

FinCEN had reason to believe that “LCB had been routinely used by drug-traffickers and money launderers operating in various countries in Central and South America, Europe, West Africa, the Middle East, and the U.S.; that Hezbollah, which Lebanon considers to be a legitimate political party and resistance organization, generated revenues from the criminal activities of this network and that LCB executives who are complicit in money laundering activities provided financial services to Iranian officials.”¹³⁹

Back in 2009, a trusted billionaire Shiite businessman and financier from southern Lebanon, Salah Ezzedine who “organized pilgrimages to Mecca, ran a major Beirut publishing house and a children’s television station, held major investments in eastern European oil and iron conglomerates, and – much more to the point – was a close personal friend of very senior leaders of Hezbollah, turned out to be an ‘Abu Madoff’, declaring himself bankrupt, to the tune of \$1.195bn, after promising his trusting investors an astonishing 40 per cent interest on their deposits – which, according to judicial officials in Lebanon, he eventually could not pay. It appeared

¹³⁷ Federal Register, “A Notice by the Financial Crimes Enforcement Network (FinCEN),” see at <http://www.federalregister.gov/articles/2011/02/17/2011-3346/finding-that-the-lebanese-canadian-bank-sal-is-a-financial-institution-of-primary-money-laundering>

¹³⁸ Ibid.

¹³⁹ Ibid.

that Ezzedine's financial collapse became inevitable after he wrote a \$200,000 cheque to Hussein Hajj Hassan, one of Hezbollah's general secretary Hassan Nasrallah's closest political advisers and a Hezbollah member of parliament. The cheque bounced. The response to this within Hezbollah's bunkers can only be imagined."¹⁴⁰

To the deep embarrassment of the Iranian-financed and armed militia, Hezbollah remained strangely silent, an unusual characteristic for such a publicity-conscious movement who had built its prestige in the Arab world on its squeaky-clean reputation for financial and political probity. Some commented that Middle East dictatorships and the third-rate leadership of the Palestinian Authority may salt their millions away in foreign bank accounts, but not the 'incorruptible' Hezbollah whose own millions – faithfully shipped in US currency bills to Beirut from Tehran – rebuilt dozens of Shiite Muslim villages in southern Lebanon and thousands of home-owners in the Dahiya area of Beirut that were destroyed in Israel's bombing of Lebanon in 2006.

Lebanon's banks had no exposure to a "Bernard Madoff-style Ponzi scheme"¹⁴¹ run by a Lebanese businessman accused of defrauding investors. Lebanon's Central Bank governor Riad Salameh said "there is no exposure by the banks to it,"¹⁴² and "it has nothing to do with the finance or banking industry. He had his own investors, and it's a private matter that's outside of the banking industry."¹⁴³

The scandal has embarrassed Hezbollah which prides itself on a reputation for honesty and selfless piety. It has also illustrated the way many of Lebanon's Shiites, despite their ascent from near feudal poverty just a few decades ago, remain in some

¹⁴⁰ Fisk, Robert, "Lebanon's Madoff bankrupted after bouncing \$200,000 cheque to Hezbollah," *The Independent*, 8 September 2009, <http://www.independent.co.uk/opinion/commentators/fisk/lebanons-...>

¹⁴¹ Madoff was sentenced in June to 150 years in a U.S. federal prison for a \$65 billion Ponzi scheme.

¹⁴² Derhally, Massoud, "Lebanon's Banks Not Exposed to Ezzedine Ponzi Scheme (update 1)," September 6, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid...>

¹⁴³ Ibid.

ways a nation apart. Their residual distrust of mainstream Lebanese institutions, which helped fuel Hezbollah's rise as a virtual state within a state, also appears to have made them vulnerable to Mr. Ezzedine's schemes.

"It is still not clear what happened to the money,"¹⁴⁴ according to a judicial official with knowledge of the case who spoke on condition of anonymity, saying he was not authorized to comment publicly. "Mr. Ezzedine, who is now in jail awaiting trial, invested in metals, oil and other commodities in Africa and the Middle East, according to several people who knew him."¹⁴⁵

In response to US pressures regarding the Lebanese Canadian Bank SAL, Mr. Salameh said that "Beirut financial authorities are continuing to investigate the Lebanese Canadian Bank whereas an autonomous Special Investigation Commission is initiating procedures and conducting investigations...concerning the accounts that cause concern."¹⁴⁶

Executives at Société Générale and SGBL took stringent efforts last year to ensure that none of LCB's suspect accounts were transferred to SGBL. The bank hired Ernst & Young LLP, Deloitte & Touche LLP and the Ashcroft Group, headed by former U.S. Attorney General John Ashcroft, to oversee the auditing of these assets.

"SGBL's first priority is compliance with strict anti-money laundering principles, over and above U.S. and European standards,"¹⁴⁷ said Mr. Ashcroft, who continues to advise SGBL. "Their first step in the acquisition was to institute a robust filtering process that identified and rooted out potentially criminal and terrorist-related assets before any purchase could be made."¹⁴⁸

¹⁴⁴ Ibid.

¹⁴⁵ Ibid.

¹⁴⁶ Solomon, Jay, "U.S. Probes Lebanon Banking Deals," The Wall Street Journal, April 26, 2012, see at <http://online.wsj.com/article/SB10001424052702303990604577368212835080388.html>

¹⁴⁷ Ibid.

¹⁴⁸ Ibid.

Mr. Ashcroft and SGBL officials said LCB's board was fired as part of the merger, as well as roughly half of the bank's original 720 employees. Of the remaining 370 employees, most are lower-level workers, such as bank tellers, but some senior-level managers from the Lebanese Canadian Bank remain at SGBL. Among them are two former top officials of Prime Bank Gambia Ltd., which was majority-owned by Lebanese Canadian Bank before it closed last year, SGBL confirmed. They were Prime Bank Gambia's chairman and its chief executive when it was cited last year by the Treasury for alleged money-laundering activities.

The Lebanese Canadian Bank case ended up with the Lebanese banking sector being exposed to international and US scrutiny. Accommodating to the US demands is a short-term solution but the consequences and costs for implicating not only the Lebanese financial system but also the Central Bank and its governor could be heavy.

In the *International Narcotics Control Strategy Report (INCSR)* of March 2012, the U.S. Department of State claimed that “Lebanon faces money laundering and terrorist financing vulnerabilities and that part of the generous flow of remittances from the Lebanese Diaspora, estimated at \$7 billion – 21% of GDP – in 2009, according to the World Bank, could be linked to underground and *Trade-Based Money Laundering (TBML)* activities.”¹⁴⁹

Moreover, illegal proceeds come primarily from local criminal activity and organized crime. Lebanon’s Customs supervises two free trade zones operating in the country. While Lebanon has ratified the U.N. Anti-Corruption Agreement pursuant to Law No. 33/2008 in addition to the issuance of Law No. 32/2008 which granted the SIC the power to investigate corruption related cases, high levels of corruption create

¹⁴⁹ Ibid.

vulnerabilities for TBML and other threats. On the other hand, Lebanon has not yet agreed to a cross-border cash reporting system, resulting in major cash-smuggling.

After 9/11, Arab states have become increasingly aware of the need to play an active role in combating money laundering and terrorist financing by forging partnerships with the international community. Several Arab states have embarked on a series of financial and regulatory reforms to their banking and financial markets in accordance with their legal frameworks and cultural values. On-site evaluation visits by FATF to MENA countries confirmed the commitment of those to create effective arrangements to combat money laundering and terrorist financing, in line with FATF Recommendations as well as international standards and best practices.

The thesis now turns to its concluding chapter by answering the research question stated at the outset of the thesis: can Lebanon sustain its leading role as one of the most important financial and banking centers in the Middle East based on its longstanding banking secrecy law while proving itself compliant with international pressures regarding anti-money laundering and counter financing of terrorism global standards.

CHAPTER SIX

CONCLUSION

The concluding chapter seeks to summarize various discussions in the thesis and provides an answer to the central research question: How has Lebanon sustained its leading role as one of the most important financial and banking centers in the region based on its longstanding banking secrecy practices as well as complied with international pressures regarding anti-money laundering and combating the financing of terrorism international standards? The chapter will also contribute to answering several other relevant concerns important for both their theoretical and policy-making implications. Through policy and discourse analysis, it will discuss different perspectives of international relations theory, the role of international law, IGOs, and NGOs in policy formation and how these may shape issues and affect state's agenda, the still to be unrivaled sole proprietor of power, on several global issues such as money laundering and terrorist financing within the contextual change in world politics.

6.1 Answering the Research Question

A scrutiny of the existing laws and by-laws concerning the subject matter at hand, this thesis examines how Lebanon's domestic politics and law-makers, though differing on countless issues, agree on the importance of preserving a strong financial system – more specifically a surviving economy – and the likely consequences of failure. By framing a direct relationship between an independent Central Bank and a benign political will, compliance to AML/CFT international standards can be only assessed within the confines of maintaining the bank secrecy, in justifying a more democratic financial market's mechanism, and in defense of the sovereign state and

its citizens. Compliance is established through regulatory laws and supervision, however, certain impediments to the law authorities such as tipping-off and high level corruption can lead to weakening the country's compliance with international standards due to lack of meaningful sanctions and material convictions. Nevertheless, non-compliance with international standards would have placed severe costs on the financial system and the economy being designated as non-compliant with respect to anti-money laundering and counter-terrorist financing standards.

In the last few years, “with every major national, regional, or international failure of governance, a financial scandal has been found lurking. With each scandal has been the systemic use of banking and financial secrecy to hide criminal activity. Incessantly, political conflict and political destabilizing activity, including grand corruption, drugs trafficking, arms smuggling, and civil war have been facilitated and sustained by illicit finance networks set in the world's licit financial services infrastructure. Major international banks in Europe, the Americas and the Middle East processed the funds moved from the Persian Gulf by al Qaeda and Osama bin Laden to terrorist cells around the world, transmitting them electronically into cash delivered by automated teller machines. Even countries with strong anti-money laundering, financial transparency and disclosure systems continue to find themselves victimized by regulatory failures. The common infrastructure of global banking and financial services has been abused by criminals to accomplish serious crimes.”¹⁵⁰

Affluent countries like the G8 members or the European Union “may be able to endure and eventually eliminate abuse of their financial institutions by criminals, fraudsters, corrupt officials, and terrorists who launder hundreds of billions of dollars

¹⁵⁰ Taylor, Mark, “Economics of Conflict: Private Sector Activity in Armed Conflict,” FAFO Program for International Co-operation and Conflict Resolution, Emerging Conclusions (March 2002), see at <http://www.fafonsp/emrg302.pdf>

per year in illicit funds.”¹⁵¹ On the other hand, economies of developing countries, “the theft of natural resources or development assistance, international aid, capital losses from public funds gone missing, or the perversion of government institutions through bribery, create burdens that are not so easily managed.”¹⁵²

“There is a rising concern that globalization has made possible the augmentation of local financial problems into international ones. Indeed, regional and international financial contagions are a direct result of a process of globalization that has also facilitated the transmission of financial crises across national borders. Illicit finance has played and continues to play a key role in undermining many of the goals of the U.N. and international security policy. Dirty money laundered through international financial institutions threatens democracy, human rights, free markets, the environment, sustainable development, global governance, political stability, and civil society. Financial transparency is the basic structural requirement by which governments; regulators, law enforcement, judicial authorities, and civil society can advocate supervision and be adamant on the accountability of both essential private sector and public sector actors.”¹⁵³

Since no state acting alone can achieve its aims; international co-operation is crucial; and international law is the framework within which international co-operation takes place. This was made clear by the former British Foreigner Secretary, Douglas Hurd who claims that “nation states are...incompetent. Not one of them, not even the United States as the single remaining super-power, can adequately provide for the needs that its citizens now articulate. The extent of that incompetence has become sharply clearer during this century. The inadequacies of national governments to provide security, prosperity or a decent environment have brought into being a huge array of international rules, conferences and institutions; the only answer to the puzzle of the immortal but incompetent nation state is effective co-operation between those states for all the purposes that lie beyond the reach of any one of them.”¹⁵⁴

¹⁵¹ Ibid.

¹⁵² Ibid.

¹⁵³ Ibid.

¹⁵⁴ *The Sunday Times*, Editorial, “Stop the Pressure, Give Space to LLRC,” (12 June 2011) see at <http://www.sundaytimes.lk/110612/Editorial.html>

Reference to the vast assortment of international rules, conferences and institutions suggests something of the processes by which the rules of international law are made. Take for example the question of terrorist financing. No state can prevent global terrorism by acting alone. It may impose severe restrictions upon its financial system and engage in massive counter-financing of terrorism measures; but if no other state is doing so, its efforts will be practically pointless. Worse, the additional costs imposed on financial institutions and citizens as a result of those measures will tend to put that state's economy at a competitive disadvantage.

Unilateral action is at best ineffective and may be positively counter-productive. In a perfect world, all states would impose the same counter-financing of terrorism policies, at a level sufficient enough to achieve the desired safety of the international financial system. Co-operation is indispensable; and co-operation needs a framework. States must contact each other and know who is competent to give binding rules that will be respected by the government, the legal systems, and other public authorities of partner states. They need to show how a particular agreement approved by a state is legally binding, and is not regarded simply as a matter of policy that can be changed or abandoned at will by the other state. These matters are governed by principles of diplomatic law and treaty law.

What international law does and how the international legal system operates is well expressed by J.L. Brierly who states that "any intelligent study of the problems of international relations must raise the question of the role, if any, to be assigned in them to law."¹⁵⁵ Brierly believes that "some knowledge of the system as it is actually practiced between states is vital as an antidote both for exaggerated hopes and for

¹⁵⁵ Brierly, J.L., *The Law of Nations: An Introduction to the International Law of Peace*, (Oxford: Oxford University Press, 1928), p. v.

cynical indifference,”¹⁵⁶ and he contemplates that “international law is neither a chimera nor a panacea, but just one institution among others which we have at our disposal for the building up of a saner international order.”¹⁵⁷ We turn now to an assessment of the theoretical perspectives of international law.

6.2 The Role of International Law

Ever since the beginning of the new millennium, international law has captured the headlines more than perhaps at any other time. In the aftermath of 9/11, the U.S. military responses to terrorism in Afghanistan and Iraq, and mounting humanitarian crises, international treaties have become well-known. International law consists of a body of both rules and norms regulating the interactions among states, between states and intergovernmental organizations (IGOs), and in more limited cases among IGOs, states, and individuals. These norms demand obedience and compel behavior.

At the state level, law is hierarchical. Established structures exist for both making law (legislatures and executives) and enforcing law (executives and judiciaries). In the international system, authoritative structures are absent. Given the absence of a sovereign body with enforcement power, is there international law, and why comply? Legal scholar Christopher C. Joyner argues that “international legal rules obtain their normative force not because any superior power or world government prescribes them but because they have been generally accepted by states as rules of conduct, with the expectation that states will follow suit.”¹⁵⁸

On the other hand, realists remain skeptical about the utility of intergovernmental organizations, non-governmental organizations, and international

¹⁵⁶ Ibid.

¹⁵⁷ Ibid.

¹⁵⁸ Joyner, Christopher C., *International Law in the 21st Century: Rules for Global Governance*, (Lanham, Md.: Rowman & Littlefield, 2005), p.6.

law. In the view of many, these are but reflections of state power and hence have no independent identity or role in international relations. Radicals, too, view international organizations and law as mere reflections of political and economic hegemony. However, liberals and constructivists believe that IGOs, NGOs, and international law matter, yet with a different emphasis. To liberals, these organizations and international law do not replace states as the primary actors in international politics, although in a few cases they may be moving in that direction; but they do provide alternative venues to discuss the new globalizing issues and an arena for action, whether intergovernmental or private, for states themselves and for individuals to join with other like-minded individuals in pursuit of their objectives. Constructivists place critical importance on institutions and norms. The emphasis is on how changing norms and institutions shape issues. Both IGOs and NGOs can be norm entrepreneurs that socialize and teach states new norms. Those norms may change state preferences, which, in turn, may influence state behavior.

6.3 Assessing Unanswered Questions in the Thesis

The 2008 global crisis has given way to a proliferation of international consensus meant for increasing oversight and supervision of financial markets participants. Yet how these rules work is not well understood. Because international financial rules are expressed through informal, non-binding accords, scholars tend to view them as either weak treaty substitutes, or by-products of national power. Rarely, if ever, are they cast as independent variables that can inform the behavior of regulators and market participants alike. Anti-money laundering and combating the financing of terrorism international standards present an alternative theory for understanding their rationale, processes, and limitations. Drawing on a close analysis of the post-crisis financial system, “international financial law is often bolstered by a

range of reputational, market, and institutional mechanisms that make it more coercive than classical theories of international law predict.”¹⁵⁹

The FATF provides a sophisticated soft law that offers a lucid and comprehensible introduction to several regulatory bodies and coordinating networks that contribute to the oversight of global finance. As noted before, “the PATRIOT Act and FATF are two major tools which, along with other related legislation in individual countries, have formed a multifaceted, globally interconnected system of laws and regulations that international financial systems must know.”¹⁶⁰

As well, the complexity of how instruments like the UNSCRs, the EU Directives, and the FATF recommendations are implemented in different legislation of member countries is so huge that there is an palpable need for coordination and flexibility of entry for all nations including least developed countries to be involved in the fight against money laundering and terrorist financing.

“The existing international initiatives to react to these problems are creating a global system of international standards for transparency. There is mounting evidence to justify questioning whether global financial institutions transferring money instantaneously across national borders can be readily regulated or supervised by any one organization. While these financial institutions may have their headquarters nominally based in a single country – typically one of the G8 countries, the EU or Switzerland – they generate profits and carry out activities on a global basis involving several FATF member states. As a result, they are for many reasons beyond the capacity of any single state to police.”¹⁶¹

6.4 Global Economic Interdependence

Robert O. Keohane and Joseph S. Nye argue that “the international organization model assumes that a set of networks, norms, and institutions, once

¹⁵⁹ Brummer, Chris, “Soft Law and the Global Financial System: Rule Making in the 21st Century,” (Cambridge University Press, 5 June 2012), see at <http://www.betterread.com.au/book/soft-law-and-the-global-financial-system-rule-making-in-the-21st-century-book-9781107004849.do>

¹⁶⁰ Kalin, Christian; Goldsworth, John; Muller, Wouter; “Anti-Money Laundering: International Law and Practice,” (Electronic Book, 2007), see at <http://www.greatbooksdownloads.com/Anti-Money-Laundering-International-Law-and-Practice/p254380/>

¹⁶¹ Taylor, Mark, “Economics of Conflict: Private Sector Activity in Armed Conflict,” Fafo Programme for International Co-operation and Conflict Resolution, Emerging Conclusions (March 2002), see at <http://www.fafo.no/nsp/emrg302.pdf>

established, will be difficult either to eradicate or drastically to rearrange. Even governments with superior capabilities will find it hard to work their will when it conflicts with established patterns of behavior within existing networks and institutions. Under these conditions the predictions of overall structure theories will be incorrect: regimes will not become congruent with underlying patterns of state capabilities, because international organizations... will stand in the way.”¹⁶²

Perhaps an examination of the phenomenon of global economic interdependence is essential for our understanding of the present day international system. Keohane and Nye highlight that “advanced communications, economic and social transactions, and human aspirations are creating a world without borders, a global village, and an era of interdependence.”¹⁶³ Interdependence refers to a state of mutual dependence in which the outcomes of specified actions are characterized by asymmetrical reciprocity among actors in different countries.

First, in an economic sense, interdependence is present when there is increased national sensitivity and vulnerability to external economic conditions. According to Keohane and Nye, sensitivity “involves degrees of responsiveness within a policy framework how quickly do changes in one country bring costly changes in another, and how great are the costly effects; whereas vulnerability is defined “as an actor’s liability to suffer costs imposed by external events even after policies have been altered.”¹⁶⁴ Here, interdependence, with its dimensions of sensitivity and vulnerability, is seen as a process by which a power relationship among groups and societies outside state’s control can be established.

¹⁶² Keohane, R. O. and Nye Jr., Joseph S., “Power and Interdependence, World Politics in Transition,” Boston: Little, Brown and Company, 1977.

¹⁶³ Ibid.

¹⁶⁴ Ibid.

Second, in a political sense, complex interdependence undermines an international hierarchy in terms of linkages across issue-areas, in terms of formal contacts between societies. Keohane and Nye note that “under conditions of complex interdependence, strong states would find it more difficult to use their military strength to control the outcomes on issues of non-military nature; that military security does not always dominate the international agenda; and that national societies interact through multiple channels and not just through inter-governmental contacts.”¹⁶⁵

Furthermore, the authors argue that a broader approach to global affairs beyond the state-centric (realist) view is needed in order to comprehend the present transition in international relations. They define world politics “as all political interactions between significant actors in a world system in which a significant actor is any somewhat autonomous individual or group that controls substantial resources and participates in political relationships with other actors across state lines. Such an actor need not be a state.”¹⁶⁶

Keohane and Nye do not argue that this complex interdependence truly reflects world political reality. They believe, however, that cooperation among nations, the greater role played by non-governmental actors, the close link between domestic and foreign policies, international regimes, and the role of international organizations in political bargaining hold the answer to world problems. They define regime is “as a set of norms, rules and decision-making procedures worked out by the interested states to regulate their relationship in a given issue-area.”¹⁶⁷

Understanding the development of regimes is central to understanding the politics of international organizations. There are numerous examples which can be

¹⁶⁵ Ibid.

¹⁶⁶ Ibid.

¹⁶⁷ Ibid.

cited in the regime literature, it would be that of both the United Nations, for the matter at hand, with its conventions and the Financial Action Task Force recommendations for anti-money laundering and counter-financing of terrorism. In 20 years of its existence, the FATF has made considerable progress in identifying and coordinating the response to global threats posed by illegal financial activity.

6.5 The Challenge to Realism from Interdependence

Complex interdependence as described in Keohane's and Nye's work, consisting of multiple channels of communication, the absence of hierarchy among issues, with military force playing a minor role, did not so much rock the foundations of Realist orthodoxy as knock politely on the door. Keohane and Nye restricted the use of the concept applying their work to economic issues, only offering complex interdependence as an alternative to Realism when it provides greater understanding of the nature of the issue in a particular situation, an area where realists were willing to concede to a development of their ideas to encompass the changing economic realities. Terrorism is multi-faceted and multi-dimensional. It represents a challenge to the orthodox view of separation of domestic and foreign policy by International Relations scholars, and it necessitates multi-lateral co-operation among governments. The domestic effects of international terrorism can be seen to blur the artificial divide between what have been seen as two separate fields of study.

However, James Rosenau states in *The Study of Global Interdependence* that "the restriction of the concept to economic issues and thereby merely adapting the Realist paradigm to changes in the real-world limits the usefulness of the concept."¹⁶⁸ Interdependence, when followed to its logical theoretical conclusions, giving non-

¹⁶⁸ Rosenau, J. N., *The Study of Global Interdependence: Essays on the Transnationalization of World Affairs*, (Frances Pinter, London, 1980).

state actors influence in world affairs, is a direct challenge to the Realist paradigm. Furthermore, a focus on the issues and interactions among actors, rather than the units themselves, and the idea of a multiple issue-based systems, rather than a single international system, with each system featuring a unique cast of governmental, inter-governmental and non-governmental actors gives a more useful framework for an analysis of regime creation. Global action on terrorism clearly demonstrates the immediate and increasing interdependence of world politics as understood by Rosenau, with the inclusion of non-state actors giving the term interdependence a greater meaning. No one country can hope to isolate itself from such a transnational phenomenon, or hope to resolve its domestic terrorism independently.

Rosenau identifies four characteristics that seem salient as central features of all the diverse issues of interdependence which “involve highly complex and technical phenomena, have non-governmental actors and fragmented governmental decision-making, and necessitate multi-lateral co-operation for their management.”¹⁶⁹ Global response to terrorism clearly demonstrates the features of interdependence as outlined earlier. Furthermore, as Rosenau explains, “most of the issues overlap so thoroughly that proposed solutions to any one of them have important ramifications for the others.”¹⁷⁰ Terrorism phenomenon clearly illustrates these two points. As has already been stated, terrorism is a multi-faceted and multi-dimensional problem and is too complex to be viewed as a single issue.

Rosenau’s concept of interdependence as outlined above challenges the traditional distinction between domestic and international politics in Hans Morgenthau’s analysis of international politics that views “the nation-state as the sole,

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

principal actor in the international arena and that the dominant issue in international relations is the struggle for power.”¹⁷¹

Efforts to fight terrorism suggest the domestic and the international are inextricably linked. Indeed, with the case of the counter-financing of terrorism in the aftermath of 9/11, international legislation preceded national legislation, challenging another Morgenthau concept, central to the Realist understanding of agenda-building, that of the national interest as well as state sovereignty suggesting that no one country can deal with this multi-faceted and multi-dimensional phenomenon in isolation. The terrorist organizations of today vary widely, ranging from large, structured groups to small, decentralized and self-directed networks. Detecting and disrupting a specific terrorist attack via monitoring of the financial system is extremely challenging, however, “The direct costs of a terrorist attack are only a fraction of a terrorist organization’s demand for funds. The broader organizational costs of maintaining a terrorist network are more substantial and therefore easier to detect and disrupt. If these larger financial flows can be stemmed, the reach and capabilities of terrorist organizations can be curtailed.”¹⁷²

6.6 Global Politics and Interdependence

The concept of international regimes as “sets of governing arrangements that affect relationships of interdependence,”¹⁷³ has been developed by the traditional Realist school of International Relations, in response to the challenge of interdependence and to explain the growth in new forms of co-ordination and organization. However, in this approach, “international regimes are created by states

¹⁷¹ Morgenthau, H. J., *Politics among Nations: the Struggle for Power and Peace*, (Knopf, New York, 2nd ed., 1954, first pub. 1948).

¹⁷² Financial Action Task Force, “20 Years of the FATF Recommendations 1990-2010,” www.fatf-gafi.org

¹⁷³ Keohane R. and Nye J., *Power and Interdependence: World Politics in Transition*, (Little, Brown, Boston, 1977), p. 19. For the Keohane and Nye definition of Interdependence, see p. 8.

to further the state's interests, and are not expected to survive the demise of the hegemon under which they were created;"¹⁷⁴ hence, "states are viewed as the dominant actors in the international system, but co-operation in the form of international regimes may be necessary to secure the optimal outcome under conditions of interdependence in some situations."¹⁷⁵

International regimes can and do influence behavior and outcomes in the international arena independently of the wishes or needs of state actors. As Keohane states, "if international regimes did not exist they would have to be invented,"¹⁷⁶ but in order for the concept to be analytically useful we need to see regimes as having an independent impact on world politics through a synthesis of regime literature with the literature on issues, developed by writers such as Rosenau, Mansbach and Vasquez, and Keohane and Nye, from a more thorough use of the concept of interdependence.

An alternative approach to the traditional Realist school of thought is the paradigm variously known as pluralism, the multi-centric approach, issue-politics, or the term most commonly used, Globalism. Globalism attempts to synthesize the literature on interdependence (already introduced) and international regimes with the literature on foreign policy analysis (developed by Rosenau), the literature on transnationalism and international organizations (developed by Mansbach and Vasquez (1981)). In this way Globalism allows for a greater understanding of the dynamics of change in the ever changing arena of world politics, whereas mere adaptations to an approach which emphasizes anarchy and continuity cannot do so. In Globalism, international regimes are central.

¹⁷⁴ Keohane, R., "The demand for international regimes," pp. 141-71 in Krasner (ed.), *International Regimes* (Cornell University Press, Ithaca, New York, 4th ed. 1986, first pub. 1983), and in the same volume, Krasner, "Structural causes and regime consequences: regimes as intervening variables," pp. 1-21.

¹⁷⁵ Stein, A., "Coordination and collaboration: regimes in an anarchic world," pp. 115-40 in Krasner.

¹⁷⁶ Keohane, R., "The demand for international regimes," p. 171 in Krasner.

6.7 Developing and Implementing Global Standards

The FATF's naming and shaming mechanism had successfully compelled most of the world's least regulated jurisdictions to abandon traditional notions of bank secrecy, and pledge that their financial institutions implement proper due diligence and Know Your Customer measures. But such tools are lacking since they were unsuccessful in building capacity at a national level to assess the objective and integrity of cross-border financial transactions. It is irrational to expect a small jurisdiction that hosts a subsidiary of a major international financial institution to understand the cross-border transactions of the subsidiary, let alone by its affiliates or overseas parent.

Although the most sophisticated and best regulated financial centers, including those of the G8, European Union, and Switzerland, fall short of exercising enough oversight over the global enterprises they license, they remain the most important nodes in the global financial system infrastructure. "So far these institutions and those competing with them have always taken advantage of the substantial regulatory and enforcement arbitrage afforded by the gaps in government laws and capacity to launder the illicit profits, and thereby facilitate the circumvention of national laws."¹⁷⁷

"All of the existing initiatives to promote financial transparency fail in part to tackle this problem. The FATF exercises focus on jurisdictions, not institutions, and generate black-lists, but no white lists of jurisdictions that have met the highest standards of best practices. Even if every country and territory in the world were to agree upon their standards, local failures of governmental capacity to regulate or to enforce would preserve the ability of private financial institutions that were so inclined to circumvent the global standards."¹⁷⁸

The foregoing standards have been formidable and innovative yet few expect that they will be enough. The question remains as to whether additional measures

¹⁷⁷ Winer, Jonathan M., "Globalization, Terrorist Finance, and Global Conflict: Time for a White List," *Financing Terrorism*, 2003.

¹⁷⁸ *Ibid.*

should be developed that combine the best features of existing initiatives into a regime that further attenuates regulatory and enforcement arbitrage, holds the private sector financial services infrastructure accountable, and provides incentives to institutions that implement international standards and adopt best practices.

As has been mentioned earlier in this work, the terrorism phenomenon can be seen as a number of separate, identifiable issues which can be isolated into distinct issue-systems composed of actors in contention over related values. For the actors in the financial issue-system only one of terrorism issues is salient, that of the problem of money laundering.

The adherence of the actors to the global standards can be seen to be determined, firstly, by how salient they perceive the standards to be to them in allocating stakes to satisfy a particular value by which they are guided. As has been explained, banking stability and soundness was threatened by the increase in money laundering related crimes and therefore rules such as Know Your Customer and Suspicious Transactions Reporting have replaced see no evil, hear no evil in the pursuit of efficiency and profit, which seemed so prevalent in the past. Secondly, an actor may be influenced by other actors into adhering to a particular standard. This process of socialization can be seen to have influenced the banks and financial institutions into accepting the ethical norms of the Basel Committee and is fundamental to the work of the FATF.

Krasner's definition of regime as featuring "principles, norms, rules and decision-making procedures"¹⁷⁹ is met by the Financial Action Task Force in this given area of international relations. The norm that banks should not profit from illicit funds is nearly universally accepted. The norms and standards of the regime can be

¹⁷⁹ Krasner, S. D., *International Regimes*, (Cornell University Press, Ithaca, New York, 4th ed. 1986, first pub. 1983), p. 2.

seen to have been developed by the Basel Committee and the work of the United Nations. The Council of Europe, the European Economic Community and the United States can be seen to have started to develop regional regimes for the control of money laundering and combating the financing of terrorism. However, the Financial Action Task Force is the only global body whose focus is exclusively on money laundering. The emergence of the Financial Action Task Force can be seen as the decision-making focus of a global money-laundering and financing of terrorism control regime.

Power is the ability to influence others to produce the outcomes one wants. Unlike hard power, which works through payments and coercion (carrots and sticks); soft power works through attraction and co-option. It is based on culture, political ideals, and policies. When you persuade others to want what you want, you do not have to spend as much on sticks and carrots to move them in your direction.

6.8 Soft Power and Terrorism

As a result of 9/11 and the wars that followed it (the war on terrorism, Afghanistan, and Iraq), previous constructions of national and transnational identities have been both reaffirmed and revised. However, what happened after September 11 was neither the inevitable result of developments in post-Cold War foreign policy nor a natural response to a terrorist attack. The war on terrorism was part of a larger post-Cold War vision that was fractured between two contending models, one focused on an inevitable “clash of civilizations between the West and Islam;”¹⁸⁰ the other argued for what might be described as a domino-democracy theory, which assumed that

¹⁸⁰ Huntington, Samuel P., *The Clash of Civilizations: And the Remaking of World Order*, (Free Press, 2002).

people in the Middle East and the Muslim world had aspirations to be as much like the West as possible.

With history on its predestined path, the sword, which was later so lavishly wielded by the Bush administration in an era darkened by 9/11, could be safely tucked away. But who was the enemy, if any? Bill Clinton gave a prescient answer: “We are all vulnerable to the reckless acts of rogue states and to unholy axis of terrorists, drug traffickers, and international criminals. These 21st century predators feed on the very free flow of information and ideas and people we cherish. They abuse the vast power of technology to build black markets for weapons, to compromise law enforcement with huge bribes of illicit cash, to launder money with the keystroke of a computer. These forces are our enemies.”¹⁸¹

In *The Paradox of American Power*, “Joseph Nye opened an important discussion about the varieties of power that the United States brings to bear as it goes about the task of building its world order.”¹⁸² Nye concentrated on two types of power: hard and soft. In Nye’s analysis, hard power (military and economic power) works because it can make people do what you want them to do. Soft power – cultural power, the power of example, the power of ideas and ideals – works more subtly: it makes others want what you want. In the case of the American world order, soft power upholds the order because it influences others to like the American system and support it of their own will.

According to Nye, “soft power is not weakness; on the contrary, it is the failure to use soft power effectively that weakens America in the struggle against

¹⁸¹ “Address to the U.N. General Assembly,” September 22, 1997, in USIA, *U.S. Information and Texts*, no. 038/A, September 25, 1997, p. 2 (emphasis added).

¹⁸² Nye, Joseph S., *The Paradox of American Power: Why the World’s Only Superpower Can’t Go it Alone* (Oxford: Oxford University Press, 2002).

terrorism.”¹⁸³ Hard power, which relies on coercion, grows out from military and economic might. It remains indispensable in a world populated by threatening states and terrorist organizations. But soft power will become increasingly crucial in preventing terrorists from recruiting new supporters, and for obtaining the international cooperation necessary for countering terrorism.

America remains the one most powerful nation since the Roman Empire, but like Rome, America is neither invincible nor invulnerable. Rome did not succumb to the rise of another empire, but to the onslaught of waves of barbarians. Modern high-tech terrorists are the new barbarians. The U.S. cannot alone hunt down every Bin Laden or suspected Al Qaeda leader. Nor can it launch a war whenever it wishes without alienating other countries.

The war on terrorism is not a clash of civilizations – Islam versus the West – but a civil war within Islamic civilization between extremists who use violence to enforce their ideas and a moderate majority who wants things like jobs, education, health care, and dignity as they pursue their faith. America will not win unless the moderates win.

The rigidity of the Cold War gave the discipline of International Relations an excuse for not taking into account the advances, concepts and methods from alternative disciplines such as sociology, philosophy, anthropology, and history, with their concepts of identity, values and community. The connections among these and International Relations need to be explored in order to understand and respond to the current changes in world politics.

“With the Cold War’s end, Americans became more interested in budget savings than in investing in soft power. Indeed, the combined cost for the State Department’s public diplomacy programs and all of America’s international

¹⁸³ Nye, Joseph S., “Soft Power and the Struggle against Terrorism,” Project Syndicate (21 April 2004), see at <http://www.project-syndicate.org/commentary/soft-power-and-the-struggle-against-terrorism>

broadcasting is just over \$1 billion, about the same amount spent by Britain or France, countries that are one-fifth America's size and whose military budgets are only 25% as large. No one would suggest that America spend as much to launch ideas as to launch bombs, but it does seem odd that the U.S. spends 400 times as much on hard power as on soft power. If the U.S. spent just 1% of the military budget on soft power, it would quadruple its current spending on this key component of the war on terrorism. If it is to win that war, its leaders are going to have to do better at combining soft and hard power into smart power.¹⁸⁴

To conclude, the rationale for how and why issues come on to the agenda, and how and why regimes are created from certain issues and not others, is showed as different stages in the same process of agenda-building. A clearer understanding of values and norms, their evolution and role in international decision-making, is needed to give international regimes an independent impact in international relations and is also central for an alternative understanding of change in world politics. For the traditional Realists, change in world politics is defined in terms of changes in state power, and the emergence of regimes is similarly defined. An alternative approach to the emergence and role of international regimes challenges this established belief by asserting that agendas are determined by the attempts of actors to allocate values authoritatively on specific issues. Therefore new actors can be considered from both above and below the state, and we do not just need to consider the state.

This thesis has aimed at not only answering the question how Lebanon has sustained its leading role as one of the most important financial and banking systems in the region based on its longstanding banking secrecy law while maintaining compliance with international standards, but also by setting the terrorism phenomenon into an initial theoretical framework within International Relations theory. The significance of what are viewed as the two major competing paradigms to explore the complexity of a multi-faceted and multi-dimensional phenomenon has been

¹⁸⁴ Ibid.

examined. The belief in a regime analysis which emphasizes the role of norms and values in agenda-formation, rather than focusing on rules and decision-making procedures, is necessary for an understanding of how best to fight terrorism.

Lebanese authorities, especially the Central Bank, deal with a banking system that is the most developed in the region. The country's familiarity with economic stresses and past experiences has informed a vigilant Central Bank in its attitude towards troubled institutions. The Central Bank's first point of action is the supervision and monitoring through direct intervention as in the case of al Madina Bank in July 2003. The Central Bank took control of al Madina on charges that the bank's management was involved in embezzlement, misappropriation of funds, fraudulent practices, and failure to abide by standard accounting principles. Hence, the Special Investigation Commission issued a freeze of accounts and assets order linked to 19 individuals (including the chairman of the bank) in addition to two related entities. In other cases, the Central Bank may request that the troubled bank increases provisions, improves risk controls, or injects extra capital. When these measures fail, the Higher Banking Control Commission will enforce a number of measures in attempt to remedy the situation. Consequently, the bank in question could be forced to either merge with a stronger peer or go into voluntary liquidation as in the case of the Lebanese Canadian Bank that was discussed earlier in the thesis.

But there remain much to be done. The use of financial channels to conceal and transfer the proceeds of criminal activity and to facilitate the funding of terrorist operations is a problem that will not disappear. As the systems for combating money laundering and terrorist financing are reinforced, criminal and terrorist organizations will continue to adapt their methods in order to circumvent the safeguards put in place. There is therefore a critical need for all stakeholders to remain vigilant in

identifying and responding to changing threats in order to prevent abusers of the financial system from remaining one step ahead of efforts to curb their activities. Terrorist organizations will continue to receive crucial support, in some cases active financial and material support, from safe havens, failed states, and state-sponsors of terrorism. Such support may simply reflect weak government.

Enhancing the Lebanese government's capacity and commitment to undertaking a strategic surveillance initiative and national threat assessment that, as it matures, will provide a long-term view of money laundering and terrorist financing threats is central in identifying systemic threats and encourage new thinking about priorities and counter-measures. While engaging law enforcement authorities and well informed oversight bodies even as opting for financial transparency are key factors in creating a long-term solution in responding to an ever changing global environment. Within this strategic context of government empowerment and materializing of a Private Sector Dialogue (PSD) would reflect adherence to international norms and standards, in such a way future assistance and collaboration with the international organizations should have a twofold aim; augmenting political stability and restoring confidence within the financial system, to attract investment.

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