



DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS

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CONTACT: Brookly McLaughlin
(202) 622-1996

**Testimony of
Juan Carlos Zarate, Assistant Secretary
Terrorist Financing and Financial Crimes
U.S. Department of the Treasury
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Subcommittee on Oversight and Investigations**

Chairman Kelly, Ranking Member Gutierrez, and distinguished members of the Subcommittee, thank you for this opportunity to appear before you today and discuss the abuses by terrorists of non-traditional means of financing and the U.S. government's efforts to combat them. This is an important and complex issue, and I applaud the Subcommittee for its continued focus on the changing face of terrorist financing. The Treasury Department particularly appreciates the leadership you have provided, Madam Chair, on this and related issues.

Since September 11th, we have concentrated our attention on financially isolating those who support terrorism while building systems and capacities in the international financial system to heighten the risk and cost associated with moving tainted capital. Through an unprecedented global effort to shut down flows of money to Al Qaida and like-minded terrorist groups, it is now harder, costlier and riskier for terrorists to raise funds for their attacks. Terrorist assets and conduits of funding have been frozen, shut down or otherwise neutralized. Key facilitators have been captured or killed; otherwise sympathetic donors have been deterred or isolated, and through training and technical assistance we have increased the capacity of our global partners to combat terrorist financing.

In addition to concentrating on the formal mechanisms used by terrorists and criminals to hide sources and eventual uses of money, we have known and addressed the various informal ways that terrorist groups around the world raise and move money. We have applied a consistent approach to dealing with the relevant systemic risks attendant to different sectors of the international financial system – both formal and informal – in order to bring greater transparency and accountability to financial transactions globally. To this end, we have supported and encouraged the worldwide expansion of the regulatory oversight to previously unregulated sectors, garnered more information from the newly regulated communities, and applied enforcement pressure where needed to help ensure compliance. In many respects, these efforts have shone the light of day on previously unseen or untended corners of the financial world.

Throughout this period, there has been a growing realization internationally that securing the financial system and all vulnerable sectors – in addition to targeting the sources of terrorist support – is an essential element of our fight against terrorism and financial crimes. We must continue to build upon this strategy and systemic platform to reduce the risks associated with the movement of money in the less formal sectors of the international financial system.

Al Qaida and like-minded terrorist groups and their supporters will constantly search for the weak links in the preventative systems that are put in place in the United States and around the world. Thus, we are challenged to innovate ways of securing the international financial system and disrupting the financing that fuels terror, without doing damage to the workings of the free markets. This challenge extends to the less formal and previously unregulated sectors of the international economy.

THE EVOLVING THREAT

In the world of counter-terrorism, we are constantly facing new challenges and evolving threats. In this realm, we know that terrorist groups of all stripes use a variety of mechanisms to raise and move money. Al Qaida has used charities and deep-pocket donors to raise and move money. Hamas holds fundraising events, where like-minded individuals are invited to contribute funds ultimately meant for terrorist activities. The terrorist cell that launched the devastating attacks on Madrid's train system raised money through drug dealing. In the United Kingdom, terrorists engage in bank robberies to acquire ready cash. Colombia's notorious FARC, ELN, and AUC narco-terrorists maintain drug cartels and kidnapping operations in order to support their terrorist operations. Still others, like Hezbollah, ETA, and Jemaah Islamiyah, employ front companies and phony businesses to funnel cash or extortion taxes meant to subsidize their terrorist networks.

These are just some examples that point to the real challenges that we face. Now more than ever, it is clear that terrorist financing is not a monolithic force - but part and parcel of a nexus comprised of adept financial criminals, corruptible financial institutions, and complex ideological and financial networks. The terrorist financing threat is evolving. Terrorist financiers are constantly adjusting to international efforts to obstruct them and consistently depend on new and innovative ways to bankroll the terrorist infrastructure.

U.S. and multinational victories against Al Qaida have had a scattering effect, meaning that some of our terrorist enemies have dispersed into new and incongruous clusters. As Al Qaida balkanizes, the organizations and those localized cells that are aligned with it are relying on additional and differentiated sources of financing to survive and proliferate. These sources, we have found, include the corruption or abuse of the charitable sector and various forms of financial crime. The means of moving money across borders also varies – to include the use of cash couriers and hawaladars.

INFORMAL AND ALTERNATIVE FINANCIAL SYSTEMS VULNERABLE TO USE BY TERRORISTS AND CRIMINALS

In the larger campaign against terrorist financing, the U.S. government has focused not simply on the formal financial systems used to raise and move money but on the alternative mechanisms relied upon by terrorist groups around the world to help support their activities. In a sense, as the U.S. government and its partners – in the public and private sectors -- have made it more difficult for terrorist financiers and money launderers to use banks, terrorist groups have begun to rely even more so upon less formal methods to move money.

One of the alternatives terrorists have employed to move money is frequently termed as alternative remittance systems (ARS) -- also known as informal value transfer systems (IVTS), parallel banking, or underground banking. In a sense, referring to these alternative systems as “non-traditional” is somewhat misplaced. It is more precise to think of these as systems outside of any regulated financial system at

all. In fact, many of the so-called “non-traditional” systems we are talking about today are quite traditional within the cultures and norms of daily business in various corners of the world. There are a variety of non-traditional “systems.” Some of them, such as hawala and the Black Market Peso Exchange, are well-known to this Subcommittee. Others, such as trafficking in precious gems and the laundering of diamonds are gaining increased recognition. These diverse systems, however, do have commonalities. Virtually all of them may use trade to transfer value or provide counter valuation in order to “balance the books.” In addition, we have found that these networks operate and depend on trust. Unfortunately, this high degree of trust, often based on long-standing ethnic, family, clan or tribal ties, obstructs those trying to understand and investigate these networks and design effective policies and countermeasures to terrorist and criminal abuse.

Our approach with these sectors has been to bring them into the light of the regulatory world – through laws and outreach – and to enforce, with the help of the appropriate agencies, including the federal regulatory agencies and the Department of Justice and the Department of Homeland Security, those laws and regulations accordingly to ensure a culture of compliance with recordkeeping, due diligence, and broad anti-money laundering controls. Increased transparency and accountability, concomitantly, enhances our ability to target corrupted actors within these systems.

Charities

Perhaps the most important non-traditional method used by terrorist organizations to raise and move funds and otherwise support terrorist activity is through the corruption and abuse of charities. Numerous instances have come to light in which mechanisms of charitable giving have been used to provide a cover for the financing of terror. In certain cases the charity itself was a mere sham that existed simply to funnel money to terrorists. However, often the abuse of charity has occurred without the knowledge of donors, or even of members of the management and staff of the charity itself. Besides direct financial support, some charities also provide cover and logistical support for the movement of terrorist operatives, and others facilitate terrorist recruitment by disseminating terrorist agendas or ideologies.

Curtailing such corruption and abuse is a critical element of our general national and international strategy to combat terrorist financing, as underscored in the 2002 and 2003 National Money Laundering Strategies, numerous USG counter-terrorism strategies, and various international resolutions and standards. Efforts across the U.S. government have produced considerable results in the form of targeted actions to identify, disrupt and dismantle terrorist financing through charitable organizations. The U.S. has designated five U.S.-based charities, including thirty-five additional international charities for terrorist financing activity; prosecuted the leader of a U.S.-based charity for fraud and racketeering based on terrorist financing activity; indicted the charity and its leadership on terrorist financing-related charges; and investigated dozens if not hundreds of additional charities suspected of terrorist financing activity. Many of these investigations are ongoing.

These successful targeted actions are the product of sustained interagency coordination and collaboration. We are also engaging in coordinated efforts to improve our systemic oversight, investigation, outreach and international capabilities. At the federal level, oversight and transparency of the charitable sector is a primary concern of the Tax Exempt and Government Entities Operating Division (TEGE) of the Internal Revenue Service (IRS). TEGE examines and recognizes charities that qualify for tax exempt status, based on information submitted by charities in their application forms and annual returns. The civil examiners in TEGE have a unique familiarity with the charitable sector and the reporting, recordkeeping and disclosure obligations of the sector under the federal income tax laws. This experience is critical to the criminal investigative efforts of the Criminal Investigative Division (CID) of the IRS. The IRS has established a number of mechanisms to ensure that TEGE and CID appropriately communicate and work together on potential cases involving terrorist financing. For example, TEGE has recently revised the application form for tax-exempt status for charities (Form 1023) to include more relevant investigative information for criminal investigators in terrorist financing

and criminal cases. TEGE has also established a Screening Center to process leads from all sources, including state and local officials, on potentially abusive charities. Finally, TEGE has created a Media Relations Screening Office to identify and examine public reports on abuses within the charitable sector.

Experience gained during the past two years has also identified areas where CID can have a greater impact addressing terrorism related financial issues without duplicating the efforts of any other law enforcement agency. CID has created a Lead Development Center (LDC) to pilot a counter-terrorism project focusing on charitable abuse by using advanced analytical technology, along with subject matter experts, to support ongoing investigations and proactively identify potential patterns and perpetrators. The LDC is comprised of a staff of CID Special Agents, investigative analysts, and representatives from TEGE, who research investigative leads and field office inquiries concerning terrorism investigations. The LDC integrates its work within the larger U.S. law enforcement community, largely through CID representatives on Joint Terrorism Task Forces (JTTFs) led by the FBI. The target information packages developed by the LDC are sent to the JTTF or IRS field office that requested the analysis and to such other law enforcement entities as may be appropriate and consistent with the statutory limitations on disclosure.

The LDC also serves as a central point to de-conflict related investigations among multiple IRS field offices, and is developing distinctive analytical capabilities to include link analysis, data matching, and pro-active data modeling. Using data from tax-exempt organizations and other tax-related information that is protected by strict disclosure laws, the LDC can analyze information not available to or captured by other law enforcement agencies. By combining that data with public source information and data gathered by other criminal investigations, the LDC can perform a complete analysis of all financial data pertinent to specific targets and restrict its dissemination as required by the tax disclosure laws and the rules of grand jury secrecy. This research, technology, and intuitive modeling, coupled with CI's financial expertise, will help maximize the impact of CI resources against sophisticated terrorist organizations.

Internationally, we are working with our counterparts in Finance Ministries around the world to promote better oversight, investigation and protection of charities from terrorist abuse. Through the Financial Action Task Force (FATF), we have issued a Best Practices Paper to FATF Special Recommendation VIII (SR VIII), describing steps that charities and governments can take to attack and protect against terrorist abuse. We have also launched an internal review process through the FATF's Working Group on Terrorist Financing to improve member countries' understanding of their charitable sectors and to identify existing strengths and weaknesses in combating terrorist abuse of charities. We are globalizing this process by extending this exercise to the FATF-style regional bodies. Based on the conclusions drawn from this exercise, we are now working with our counterparts in the FATF to develop further interpretive guidance to SR VIII, which will strengthen the capabilities and commitments of member states in combating terrorist abuse of the charitable sector. We are also continuing to work with the interagency community to deliver bilateral assistance to countries to improve their oversight and investigation capabilities with respect to the charitable sector.

In addition to these oversight, investigative, international, and information-sharing efforts, the Treasury Department is engaged in sustained outreach with the charitable sector to develop protective measures against potential terrorist and criminal abuse of the sector. In April 2004, the Treasury Department hosted an Initial Outreach Event with representatives from across the charitable sector to discuss Treasury's Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities and related issues of terrorist financing in the charitable sector. Based on this meeting, the Treasury Department is continuing to work with the sector to refine these guidelines and develop better feedback for the sector on terrorist financing issues. The Treasury Department is also working with private sector watchdog groups in the charitable sector to promote awareness of terrorist financing issues and to expand this oversight mechanism to vulnerable donor and charitable communities. Finally, Treasury is also working with other U.S. agencies and the charitable sector to examine ways of promoting charitable

assistance abroad by reducing the threat of terrorist abuse. We will continue to work with the interagency community and the charitable sector to ensure that our resources, authorities and relationships are fully applied to attack and protect against terrorist abuse.

Hawalas

Hawala is a “non-traditional” value transfer system, which does not rely on the physical movement of money in order to transfer value across borders between trusted hawaladars (or brokers). Instead, transactions are conducted between trusted networks or brokers in a manner that allows the fluid delivery of cash or valued goods to remote parts of the world, which are often not yet accessed by the banking system. These transactions tend to be recorded by hawaladars with some diligence for business recordkeeping purposes, and settlements of the debts owed are often conducted via trade transfers or bank transactions.

Although overwhelmingly used for legitimate purposes such as the remittance of immigrant wages, hawala networks have also been utilized by those who finance terrorism, and their previously unregulated and informal status around the world made this sector particularly vulnerable to abuse. Treasury is confronting the potential misuse of this hawala system at multiple levels.

Internationally, we have worked with international counterparts to expand the regulation of hawaladars overseas. Within the Financial Action Task Force, we worked in October 2001, to ensure that the international community would begin to address terrorists’ abuse of alternative remittance systems. We helped establish and have driven the implementation of the FATF’s Special Recommendation (SR) VI. SR VI states that each country should ensure that individuals and entities that provide money transmission services are licensed or registered and otherwise subjected to the international standards on combating money laundering and terrorist financing, represented by the FATF 40 Recommendations and Nine Special Recommendations. This important step effectively globalized the international effort to extend government oversight to alternative remittance systems.

This effort has been taken on in other international fora. In May 2002, the Central Bank of the United Arab Emirates hosted the first international conference on hawala to discuss their characteristics and to coalesce an international approach to dealing with this unregulated sector. The resulting Abu Dhabi Declaration on hawala called for countries to put in place effective but not overly restrictive regulations on the practice of hawala. As a result, the United Arab Emirates and other countries like Pakistan have established regulatory systems – including licensing and registration program -- for the large hawala community. Progress in the UAE and other countries towards bringing the hawala system into the light of government supervision and oversight was further discussed and internationalized at 2nd Hawala Conference in Abu Dhabi last year and will continue this April at the 3rd Annual Abu Dhabi Conference on hawala.

Domestically, we have instituted federal regulations to cover the registration of money service businesses, to include hawalas in the United States. As part of the process of registration, we have engaged in a public outreach campaign to make the registration requirements known (especially in ethnic communities), and the law enforcement community has taken appropriate steps to target and prosecute unregistered money service businesses. The process of bringing into the regulated community a previously unaddressed sector of the financial system is still underway, and a major challenge for us remains the identification and registration of the hawala sector in the United States.

Black Market Peso Exchange (BMPE)

The BMPE – which is a trade-based system of moving value -- is another alternative value transfer system, used primarily in South America and the Caribbean. This system is often associated most closely with the financing and laundering of proceeds for narcotraffickers in Colombia. BMPEs have

become popular transit points for drug lords to launder their money from U.S. dollars to Colombian pesos.

This trade-based innovation has now been relied upon for a generation. Drug money laundering used to be conducted simply through large deposits of cash into US banks that were then wire-transferred to Colombian institutions. But as U.S. and international authorities cracked down, the drug traffickers were forced to innovate and turned to peso brokers to subvert new controls meant to stop them. Corrupt peso exchanges would sell the drug cartels' U.S. dollars to Colombian businesses, who would then buy American goods. Once the American goods were resold, this time for Colombian pesos, the companies could pay the broker back. After taking a healthy commission for his work, the peso broker could then return the pesos to the drug cartels themselves.

This is a cycle of dangerous money laundering that U.S. and international authorities have been fighting since the 1990's, through investigations, led by the Department of Homeland Security's Immigration and Customs Enforcement (ICE), prosecutions, and effective money freezes. There have been numerous studies of this system, and its longevity is a testament to its efficiency and usefulness to those attempting to evade a host of laws and taxes. The efforts to ferret out the illicit transactions among legitimate trade in the region are now enhanced by greater due diligence on currency exchange houses and suspicious trade transactions – as well as by heightened standards in the region related to money laundering and terrorist financing.

Cash Couriers

Another terrorist financing threat exists in the movement of bulk cash across borders, and particularly, the use of illicit cash couriers. As our efforts choke off terrorists' ability to abuse the formal financial sector and informal value transfer systems, Al Qaida and other terrorist groups have increasingly resorted to cash couriers to move their funds across borders in advance of terrorist objectives and operations.

Treasury and the interagency community, particularly ICE, have worked with our international partners to identify and attack the illicit use of cash couriers and the smuggling of bulk cash. On October 22, 2004, FATF issued Special Recommendation IX (SR IX), under which member countries should ensure that they have measures in place to detect the physical cross-border transportation of currency and bearer negotiable instruments. SR IX also, among other things, provides that countries should have competent authorities in place to stop or restrain currency and bearer negotiable instrument movements suspected of being related to terrorist financing or money laundering. Moreover, countries must maintain appropriate sanctions to deal with individuals that make false declarations or disclosures regarding the movement of bulk cash or bearer negotiable instruments. To further assist countries in developing and implementing effective measures to identify and intercept illicit cash couriers and bulk cash smuggling, we have worked through the FATF to issue an Interpretive Note and Best Practices Paper to SR IX. This guidance will assist our efforts to enhance global capability to attack terrorist financing or illicit finance through cash couriers or bulk cash smuggling.

Precious Commodities

Several reports have underscored the vulnerability of the precious commodities sector as a possible means of terrorist financing. The illicit diamond trade provides an instructive illustration of how terrorists could abuse the precious commodities industry to fund their efforts. The diamond industry describes the movement or flow of diamonds from the point of origin to the point of final use as a "pipeline." Unfortunately, the legitimate diamond processing steps of mining, trading, cutting, polishing, and retailing can be abused by corrupt regimes and criminal organizations to place, layer, and integrate illicit diamonds. To combat these risks, we must improve the oversight and transparency of the diamond and precious commodity industries through the development of effective international

standards and domestic regulation, and we must identify and disrupt illicit actors within the system through targeted actions.

The U.S. government and the international community have worked together with industry to establish international standards that address the particular concerns regarding “conflict” diamonds used to finance wars and other criminal or violent activity. The resultant Kimberley Process is an excellent example of industry, government, and NGO partnership that has helped focus attention and regulatory countermeasures on conflict diamonds.

The Kimberley Process defines guidelines in an effort to document the movement of rough stones through the diamond pipeline and to limit trade to countries participating in the Kimberley Process. The Kimberley Process requires that each shipment of rough diamonds being exported and crossing an international border be transported in a tamper-resistant container and accompanied by a government validated Kimberley Process Certificate, which is uniquely numbered and includes the description of the shipment’s contents.

The latest Kimberley Process plenary meeting that took place in Canada in October 2004 noted significant progress in the implementation of the Kimberley Process Certification scheme. Kimberley Process Participants now encompass the overwhelming majority of the producers and traders in rough diamonds. Although the Kimberley Process has made notable progress in counteracting the trade in conflict diamonds, the procedures were not designed specifically to combat diamond laundering or other financial crimes associated with diamonds. For example, the trade in rough diamonds and the mixing of parcels before being imported into a country for finishing and sale is a recognized vulnerability. There are reports that in some locations that Kimberley certificates can be purchased on the black market. Moreover, the trade in polished stones is not subject to the Kimberley Process.

The Treasury Department is responding to identified gaps in the prevention of financial crimes related to precious commodities, particularly concerns of potential terrorist financing, through sustained industry outreach and the development of effective regulation. In March 2004, William Fox, the Director of Treasury’s Financial Crimes Enforcement Network (FinCEN), addressed the 3rd Annual Meeting of the World Diamond Council, in Dubai. Director Fox and other Treasury officials have subsequently been engaged with industry representatives in other forums. This continuous dialogue has informed Treasury’s ongoing development of a rule extending anti-money laundering obligations to dealers in precious commodities, including diamonds.

FinCEN published a notice of proposed rulemaking in the Federal Register on February 23, 2003. The proposed rule set forth minimum anti-money laundering programmatic requirements applicable to dealers in precious metals, stones, or jewels to prevent money laundering or terrorist financing. This includes formal risk-based policies and procedures, with internal controls, reasonably designed to prevent the dealer from being used to facilitate money laundering or the financing of terrorist activities. Dealers are also encouraged to adopt procedures for voluntarily filing Suspicious Activity Reports with FinCEN and for reporting suspected terrorist activities to FinCEN. FinCEN will be issuing a final rule shortly.

In addition to these outreach and oversight measures, Treasury is also working with the interagency community to identify and shut down illicit financiers who have penetrated the diamond and precious commodity industries in support of criminal activities. Under Executive Order 13348, the Department is pursuing economic sanctions against members of the former Charles Taylor regime and a number of its supporters who financed criminal and terrorist activity through engagement in the diamond and timber industries, including a key Taylor supporter — the Russian-based arms trafficker Viktor Bout. Arguably the largest private arms dealer in the world today, Bout uses his fleet of Soviet-era cargo aircraft to supply guns and bullets by the ton, as well as advanced equipment such as attack helicopters to anyone willing to pay his price. In Liberia and elsewhere, Bout’s organization has reportedly

accepted payment in diamonds which can be easily and profitably unloaded in the Middle East or Europe.

All of these efforts – using a variety of tools available to us -- form part of a comprehensive strategy to deal with the vulnerabilities associated with the precious commodities market.

Trade-Related Links

We are determined to combat terrorist financing, regardless of the tactics our enemies choose to employ. As noted above, our varied efforts directed against the abuse of less formal systems and sectors are targeted in several different areas. Treasury recognizes that, similar to other fronts in the war against terrorist financing, there is no single solution or countermeasure. We must use all tools available to bring these sectors into the mainstream while ferreting out those bad actors and transactions that are abusing the systems that millions around the world rely upon for their well being. We have done this under the expansion of the Bank Secrecy Act – as laid out in the USA PATRIOT Act – and with our international engagement, which has led to better systems, capacity, and expectations of financial transparency and accountability.

In all of this, we must recognize that our terrorist enemies and their supporters are not inert but can adapt to the weapons we deploy against them.

With this in mind, we are looking to other financial systems and sectors around the world that could be used not only to skirt financial regulations but also to facilitate criminal activity and possibly terrorism. As I indicated earlier, we have helped usher the concept of financial transparency for the movement of currency and other financial products. Yet we have found that the “non-traditional” methods of transferring value we are concerned with are not adequately captured or monitored by “front door” financial reporting requirements and regulations. It may now be time to address creatively the “back door” of these systems – meaning the misuse of trade, which virtually all of the alternative remittance systems share in common.

Our experiences demonstrate that an effective way to analyze and investigate suspect trade-based activity is to have systems in place that can monitor specific imports and exports to and from given countries. There is growing worldwide recognition of entrenched patterns of trade fraud. For example, the Kimberley Process was created – in part – due to findings that massive quantities of conflict diamonds from non-diamond producing West African countries were being exported to Belgium. The former U.S. Customs Service (now known as ICE) has used the same technique of examining trade anomalies to combat the Colombia black market peso exchange, to examine suspect gold shipments from non-gold producing countries in the Caribbean, and to take enforcement action against the illegal transshipment of textiles.

We will continue to work with our colleagues from throughout the U.S. government, and particularly ICE, to detect trade anomalies that point us to fraudulent value transfers, money laundering, terrorist financing, and other financial crimes.

CONCLUSION

As the war against terrorism moves beyond the initial phases, we must continue to match the adaptations of terrorist financiers, money launderers, and other financial criminals with our own enhanced powers and steadfast resolve. Every day it becomes more apparent that following dirty money and attacking its illicit sources is an essential part of winning the financial war on terrorism. If we scatter the terrorists, deny them cash, and smother their attempts to funnel their ill-gotten gains through the international financial system, we can make their lives all the more miserable, and their despicable efforts all the more powerless.

Madam Chairman, we appreciate the Subcommittee's continued support as we endeavor to further enhance our varied efforts to combat all types of terrorist financing. We look forward to continuing our work with you on these issues, and I am happy to answer your questions.