Terrorist Financing

The Privatization of Economic Sanctions

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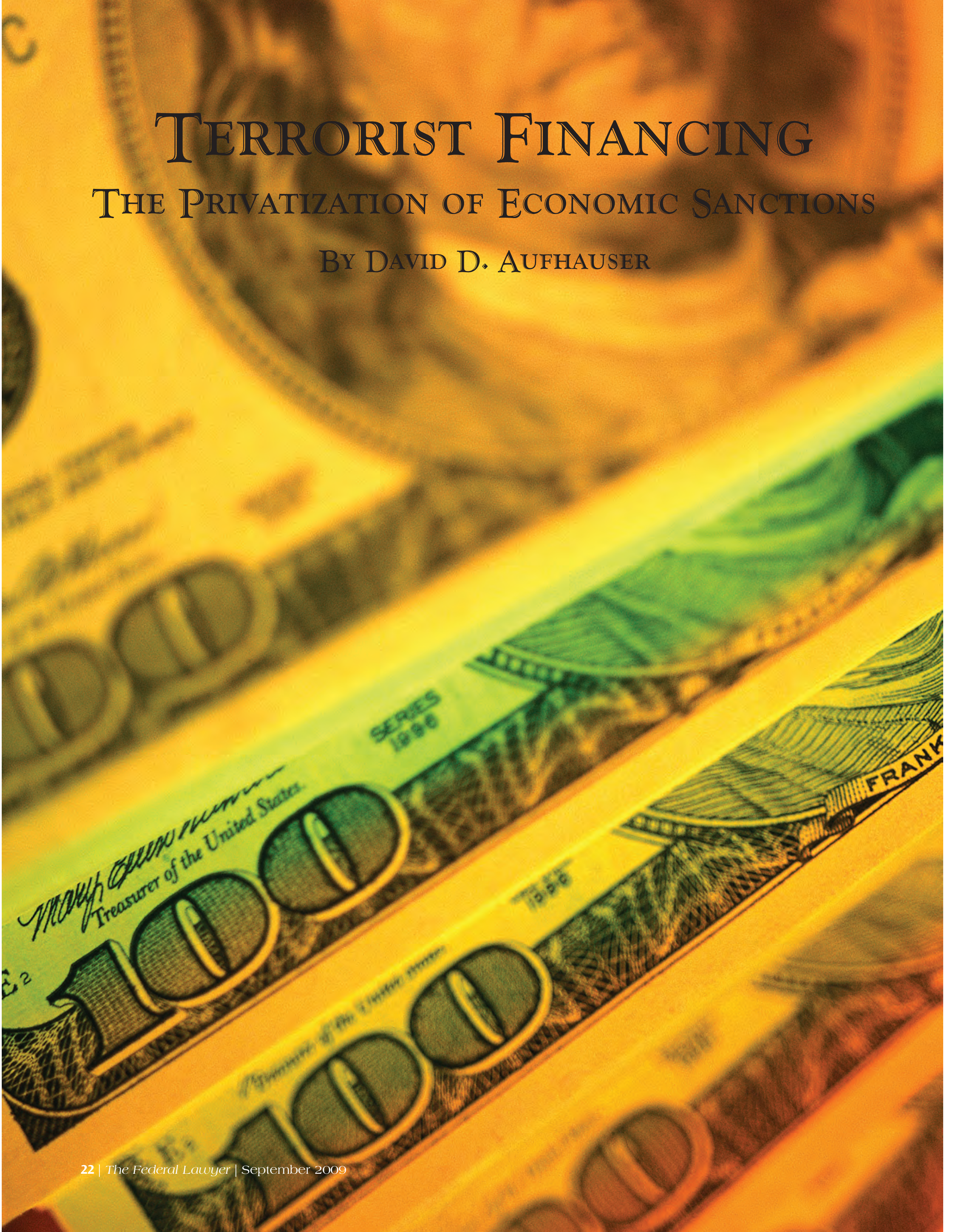

The DNA of war was altered on Sept. 11, 2001. The new threat wore no uniform. It was nonsovereign, transnational, and borderless. It flew no flag and laid no claim to territory (unless one credits quixotic stories of a return to an ancient caliphate). It did not seek to build cities, but rather, burned with the viral thought of death to innocents as warfare's highest prize.

An immediate and punishing military response to the Taliban as a state sponsor of terrorism was necessary, of course, but no one truly believed that it alone would be sufficient. The attacks on the World Trade Center and the Pentagon seemed to signal a long war to be fought largely in the shadows with alternative tools of statecraft and the attendant privacy, civil rights, and constitutional issues that characterize much of today's legal debate on the war on terrorism.

There was, however, a contrary parallel development in the area of terrorist financing that actually enhanced *transparency* through partnerships and cooperation with the private sector. The strategy, in fact, defied the popular and commonsense notion that the world of international finance is furtive and unresponsive to reputation risk.

Indeed, in the decade following 9/11, the imposition of economic sanctions—freezing assets, restraining trade, sharing intelligence on financial transactions, and prohibiting access to the channels of international banking—morphed from unilateral and highly visible exercises of presidential executive power under Article III of the USA PATRIOT Act and the International Emergency Economic Powers Act (IEEPA) to a sometimes more powerful private action by banks to a crippling and nearly universal effect. This article tells the story of how this change came about.

A Brief History of the Law

Economic sanctions have long been a common tool of U.S. statecraft, stretching back to Colonial days. The Trading with the Enemy Act of 1917 (TWEA), 50 App. U.S.C. § 3 et seq., introduced within six months of our entry into World War I, was the 20th-century iteration of this policy. The act vested broad powers in the President to "investigate, regulate, … prevent or prohibit" trade and financial transactions in times of war. At its core, the TWEA made it unlawful for any person in the United States to trade with "the enemy," unless that person was licensed by the President to do otherwise. The act also provided for the confiscation of enemy property. The term "enemy" included a sovereign nation at war with the United States, its nationals, and any individual or corporate enterprise that was allied against our national interests. The TWEA was a noncontroversial exercise of war power during a time of *declared* war.

In March 1933, Franklin D. Roosevelt invoked the TWEA to declare a bank holiday in the face of a nationwide run on the banks. The action was unheard of and unexpected, but actually endorsed five days later by Congress with affirming amendments to the TWEA. The Trading with the Enemy Act thus became an extraordinary tool of executive power that was no longer confined to hostilities. The threat to national security was no longer defined alone by bullets and boots on the ground.

By the 1970s, it had become increasingly clear that material threats to the national security of the United States were asymmetrical, nonpolar, and sometimes even targeted by undeclared foes who operated in the shadows. Indeed, without firing a shot, the world's first concerted multinational cartel—OPEC—literally darkened the White House and gave new definition to what constitutes a national emergency.

Accordingly, in 1977, the Trading with the Enemy Act was reconsidered and, once again, limited to wartime. The emerging new world in which war had no orthodox definition would be dealt with under a new law, the International Emergency Economic Powers Act (IEEPA), 50 U.S.C. § 1701 et seq., which empowered the President to declare a national emergency during peacetime in an effort "to deal with any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States." The subsequent Iranian hostage taking only underscored the wisdom of arming the President with powers to sanction adversaries that could be invoked even short of war.

The new legislation authorized the President to investigate, block, and otherwise impose restraints of trade with regard to any property or business interest of a foreign country or national thereof whose conduct is deemed to be a threat to the national security of the United States.

Moreover, under the IEEPA, the President's power to freeze assets is subject only to an administrative law standard of review for arbitrary and capricious conduct. In the absence of declared war, the potential due process concerns about such a "taking"[1] have been blunted by statutory construction and several principles of implementation adopted by the U.S. Treasury Department.

The first limiting principle is plain and straightforward. The property of a U.S. citizen *cannot* be blocked—that is, it must be "property in which any foreign country or a national thereof has an interest." Whether such an interest is enforceable or a mere expectation—for example, money left in a fishbowl found in a commercial bar believed to be sympathetic to designated foreign terrorist groups—remains largely untested. A second "brake" on the exercise of such extraordinary presidential power is a deliberately narrow definition of what it means to "block" an asset; regulators, as an act of prudence and sound constitutional footing, shy away from contending that IEEPA presidential power includes the rights of entry and warrantless search. A third self-imposed limitation involves humanitarian issues and due process challenges. The government has little appetite to seize property required to feed, sustain, house and live on. As a consequence, a liberal licensing scheme is employed to impose a technical freeze on any such assets, then to license their limited and auditable use for humanitarian needs and, indeed, legal challenge.

During the first 23 years of IEEPA's existence, "successive administrations issued fewer than two dozen orders against countries or a national thereof, placing sanctions on Afghanistan, Burma, Iran, Panama, the Russian Federation, Sierra Leone, Sudan, and Yugoslavia." "U.S. Government Efforts to Suppress Terrorism Financing," *Wake Forest Law Review* (2008). The pace picked up, however, under President Clinton with more targeted orders against nonstate actors who were disrupting the Middle East peace process—Abu Nidal, Hezbollah, Osama Bin Laden, Al Qaeda, and even the Taliban. *See*, for example, Office of the President, Executive Orders 12947 (1995), 13099 (1998), and 13129 (1999). President Clinton's reliance on IEEPA continued to expand to reach drug dealers; separatist actors in Angola; and, indeed, those who trafficked in chemical, biological, or nuclear technologies capable of accelerating the fear that weapons of mass destruction may fall into the hands of rogue nonstate actors. *See*, for example, Office of the President, Executive Order 13094 (1998). "U.S. Government Efforts to Suppress Terrorism Financing," *Wake Forest Law Review* (2008).

But no one executive order seemed to capture the global scale of the threat posed by terrorists or its immediacy. The 9/11 attacks changed that. Two legal initiatives were adopted literally as lower Manhattan was still smoldering: Article III of the USA PATRIOT Act and Executive Order 13224.

The PATRIOT Act had four significant thrusts:

- It imposed an enhanced duty of due diligence on financial institutions by increasing the standards required to "know your own customer" as well as the consequence of failing to do so.
- Notwithstanding the Right to Financial Privacy Act, the PATRIOT Act permitted and encouraged financial institutions to share data with impunity about suspect or questionable transactions—in other words, to do their own "joint digging."
- The PATRIOT Act empowered the Treasury Department to designate persons, entities, or even entire jurisdictions as "primary money laundering concerns," the "nuclear" impact of which is examined below.
- The act protected classified information from review in IEEPA freeze challenges and authorized the government to freeze assets temporarily during the course of investigation, thereby reducing the risk of flight capital.

The most powerful statement, however—one that was intended to capture much of the principles underlying the PATRIOT Act—was President George W. Bush's IEEPA executive order of Sept. 23, 2001. Executive Order 13224 was the first comprehensive move to combat the financing of terrorism on a global basis. The order stated that—

> [G]rave acts of terrorism and threats of terrorism committed by foreign terrorists … on September 11, 2001, … and the continuing and immediate threat of further attacks on the United States constitutes an unusual and extraordinary threat to the national security, foreign policy, and economy of the United States …. [I] hereby declare a national emergency to deal with that threat. I also find that because of the pervasiveness of the financial foundation of foreign terrorists, financial sanctions may be appropriate for those persons that *support or otherwise associate with these foreign terrorists*. I also find that a need exists for further consultation and cooperation with, and sharing of information by, United States and foreign financial institutions as an additional tool to enable the United States to combat the financing of terrorism. (Emphasis added).

The executive order was written with the knowledge that it could potentially test the margins of constitutional or geopolitical reach. First, it was global; it no longer focused almost exclusively on the Middle East or specific designated terrorist groups. Second, the order went far beyond sanctioning direct and knowing principals. Stated differently, Executive Order 13224 purported to reach not only those who supported foreign terrorists but also persons "otherwise associated" with suspected terrorists—including their bankers, trustees, accountants, financial advisers, lawyers, and charity conduits. The explicit target of the order was the world of finance and its intermediaries.

Moreover, Executive Order 13224 was written to reach even "unwitting" individuals and nations. It required neither scienter, mens rea, or willful blindness. Rather, it sought to impose at the outset of the war on terror a status offense and therefore an international duty of care, which, if ignored, could result in the freezing of assets or the prohibition of all trade. In an all-out attempt to raise the standards of care expected of all financial intermediaries, the President's order theoretically reserved the right to sanction even those guilty by association with terrorists.

Of course, the actual exercise of such powers was judicious and sparing and was informed by legal challenges.[2] But the potential reach of Executive Order 13224 in the early days of the campaign against terrorist financing had a profound effect on the international financial community. Doors opened, records were accessed, and management regimes were altered.

The Initial Response: Multilateralism and Eventual Push-Back

Executive Order 13224 was issued on Sept. 23, 2001, and was accompanied by an annex designating 27 specially designated global terrorist persons or organizations that were subject to blocking and trade prohibitions. Virtually all the assets and persons in question were located abroad, however. The designations may have been a useful political statement, but without international cooperation and acceptance, they risked being characterized as political theater.

It was, however, an usual time of comity and consensus. Many countries had lost nationals in the World Trade Center, and all were compelled to acknowledge the emergence of a transnational threat that respected no borders and could prove to be an elusive and powerful foe of civil society.

Accordingly, the Bush administration took its terrorist financing initiative to the United Nations at the same time that Executive Order 13224 was issued and found buy-in and resolve from UN member nations. Indeed, the UN Security Council reaffirmed a 1999 resolution condemning the Taliban safe haven for terrorism (UNSCR 1267) and established a sanctions regime that relied heavily on the initiating action of single member states to create the presumption of concerted action.

Similarly, in October 2001, the U.S. secretary of the treasury convened a special meeting of the Financial Action Task Force (FATF) to adopt a list of best practices for international financial institutions to use in blocking the financing of terrorists. Given the administration's ultimate strategic design, which was to advocate principled and commercially compelling grounds for the international financial community to assume a role as gatekeepers for national and international security, the FATF was precisely the right place to go.

The Financial Action Task Force, a creature of the Group of 7, is a loosely knit coalition of regulators of money-laundering operations from approximately 34 countries. The FATF has no true statutory, constitutional, or treaty powers, but in the area of finance, it holds a trump card—the stain of stigma and opprobrium. More particularly, the FATF reviews the anti-money laundering laws and committed resources of countries throughout the world on a rotating basis. If found wanting, the countries are warned. If the countries do not heed the warnings, they are then placed on a list of noncompliant nation-states, the consequence of which is to frustrate access to correspondent banking, trade financing, and deposit/client relationships. As noted above, the PATRIOT Act recognized the power of such "scarlet letter" designations, codified it in § 311, and subsequently used it to staggering effect in North Korea. (See discussion below.)

The emerging strategy and regime in place—Executive Order 13224, UN Security Council Resolution 1267, and the FATF principles (supplemented by parallel codes of conduct adopted by the World Bank and the International Monetary Fund)—moved forward over the years. Literally hundreds of persons or organizations were specially designated as global terrorists and their assets frozen. With the passage of time, however, the consensus evident after 9/11 paled despite attacks by terrorists in Bali, Morocco, Madrid, and London. Equitable due process objections raised by citizens in Europe—much like the U.S. legal challenge caused by the Humanitarian Law Project, discussed in footnote 2—grew to a crescendo in the face of assertions of guilt by association, but the absence of meaningful procedural avenues to test the bona fides of classified evidence. Fewer assets were actually frozen, and any action taken by governments began to run the risk of looking feckless and political. At the risk of overstating the case, concerted action by sovereign nations once again became a political football.

But what continued to multiply in quantity, sophistication, and quality was financial intelligence—the digital signature of the designs of terrorists and proliferators. And what became increasingly clear in a world of nonpolar threats populated by significant nonstate actors—multinational corporations, nongovernmental organizations, and "universal banks"—was that much could be accomplished outside the geopolitical drama taking place in nation states by enlisting and encouraging private action. Indeed, there is a gentle irony in the realization that perhaps the most powerful way to combat threats from nonsovereign actors is to enlist nonsovereign actors. The evolution of this thinking is documented in the two-year saga of the Banco Delta Asia in Macao.

North Korea, the Banco Delta Asia, and the Bad Penny

The rogue state of North Korea has bedeviled countless U.S. administrations. Traditional economic sanctions seemed to visit misery on North Korea's poor without prompting the regime to join the civil community of nations. Indeed, that regime seemed to make a holiday of sanctions by fueling a criminal enterprise of counterfeiting, drug dealing, cigarette smuggling, and the sale of missile and nuclear technology to the highest bidder. By 2005, it was plain that more inventive measures were required to police the country's international intrigue.

The common denominator in all such activity was access to the international financial system. And the U.S. Treasury Department set out to stop it in the most understated of ways—by issuing a notice of proposed rulemaking.

In September 2005, the Treasury Department issued a statement in the public register, indicating that the department had reason to believe that North Korea was engaged in illicit conduct, using accounts around the world, including a deposit of $25 million in a small bank in Macao, the Banco Delta Asia (BDA). In addition, the Treasury Department stated that it had reason to believe that the BDA lacked rudimentary controls over money-laundering and, indeed, appeared to be aware of the illicit nature of North Korea's banking. Accordingly, the department invited comment on why it should not designate the BDA as a "primary money-laundering concern" under § 311 of the PATRIOT Act, thereby cutting the bank off from the U.S. banking system.

BUT WHAT CONTINUED TO MULTIPLY IN QUANTITY, SOPHISTICATION, AND QUALITY WAS FINANCIAL INTELLIGENCE—THE DIGITAL SIGNATURE OF THE DESIGNS OF TERRORISTS AND PROLIFERATORS. AND WHAT BECAME INCREASINGLY CLEAR IN A WORLD OF NONPOLAR THREATS POPULATED BY SIGNIFICANT NONSTATE ACTORS—MULTINATIONAL CORPORATIONS, NONGOVERNMENTAL ORGANIZATIONS, AND "UNIVERSAL BANKS"—WAS THAT MUCH COULD BE ACCOMPLISHED OUTSIDE THE GEOPOLITICAL DRAMA TAKING PLACE IN NATION STATES BY ENLISTING AND ENCOURAGING PRIVATE ACTION.

The Treasury Department did not take formal action on the proposed order, however, for two years, because there was no need to do so. The notice of proposed rulemaking had an immediate global and viral impact on the BDA and North Korea. Banks around the world declined to process correspondent banking transactions, to provide trade financing, and to handle money transfers from the BDA. As a result, a run on the bank ensued. Macao authorities froze the BDA's accounts and placed the bank into receivership. And what is perhaps more important, the international financial system started to scrutinize, if not shun, North Korean transactions—at a minimum, increasing the transactional cost of doing business, and, in other cases, simply closing the door on further business. North Korea became a banking pariah without *formal* sovereign action, unilateral or otherwise.

North Korea reacted with a fury. The government walked away from the six-party talks that were going on, using a demand for the return of its $25 million BDA deposit as a proxy for a larger strategic concern that the regime was too embarrassed to admit publicly—the need for renewed access to the international banking system. Like a bad penny, the return of the $25 million became the metaphor for North Korea's frustration. Even after the United States relented and agreed that it would raise no objection to returning the money, no bank in the world would broker the transaction. In the end, the Federal Reserve Bank of New York and Russian authorities were enlisted to convince a small bank in eastern Russia to process the return of the funds.

But the genie was already out of the bottle. Not even the most senior elected or diplomatic officials in the world could diminish the unacceptable cost to their reputation that would be associated with renewing banking relationships with North Korea and North Korean entities. It would be Russian roulette to do so. As a consequence, one of Pyongyang's most prominent fears related to sanctions now rests with the private sector—the gatekeepers created in the weeks following the attacks on the World Trade Center and the Pentagon. Politicians have effectively forfeited control of the issue of imposing financial sanctions on North Korea (which may be, as some predict, why it may be unlikely that we will see § 311 used again, although its power has been indisputably battle-tested).

The Model Used for Iran: Financial Measures and Economic Sanctions

Of course, the U.S. government is not out of the business of financial sancions; it is simply smarter as a result of the BDA experience. "Graduated" measures taken to sanction Iran for its rogue nuclear ambitions is an elegant example of a marriage of public and private efforts to impose sanctions and a harbinger of future models of conduct.[3]

First, the predicate needs to be discussed. Citizens of the United States have been barred from trade with Iran for a long time now under the government's traditional use of IEEPA powers. However, because such sanctions are not universal—for example, China, Russia, and other countries look to Iran for natural resources—the impact of the historical U.S. action, although real, has been incomplete.

In September 2006, the Treasury Department took a page from its BDA playbook. It identified one of Iran's largest banks—the Bank Saderat—as a supporter of terrorism and effectively barred it from processing U.S. dollar transactions, a not insignificant consequence to an economy that is largely dependent on U.S. dollar transactions in its oil trade.

Shortly thereafter, the United States targeted a second Iranian financial institution—Bank Sepah. This time the charge was Sepah's direct involvement in masking transactions that aided the country's nuclear weapons development program. An IEEPA designation froze the bank's assets and, in effect, denied it further access to the U.S. banking system. Then, taking a page from the September 2001 playbook, both FATF and the UN were enlisted to warn the banking community of grave anti-money laundering concerns with Iran.[4]

The Treasury Department went further, however. In a remarkable series of outreach efforts during private meetings with international money center banks, Iran—much like North Korea—was identified as an unacceptable risk to the banks' commercial operations and reputations. The tool used to identify the threat was credible, reliable financial intelligence. And the consequence was an exodus of brand-name banks from conducting financial business in Iran. Those private decisions were then given effective public ratification in a March 2008 UN resolution cautioning all member states to be vigilant about Iran's banking system generally, and that of particular rogue banks identified by the United States. As a final measure, FinCen—the U.S. government's financial intelligence unit—warned that the Central Bank of Iran itself had begun to game the international financial system by eliminating evidence on wire transfers and the like that might lead to the discovery of state support for terrorism or proliferation of weapons.

The cumulative impact of such measures cannot be overestimated. Targeted sanctions—what the Treasury Department has come to call "financial measures"—have had a profound effect on sovereign nations that threaten the national security of the United States. Perhaps what is more important is that such financial sanctions equally have had a significant impact on the nonstate actors that these nations sponsor by underwriting terrorism.

Conclusion

The initiatives that the United States has taken to block terrorist financing have evolved into a sophisticated alliance of powers and parties that now confront an infinite variety of nonpolar threats—drug violence, human trafficking, terrorism, proliferation, and organized crime that corrupts sovereign policies and initiatives. What was once a blunt and sometimes politically motivated policy of unilateral sanctions has developed into a series of coordinated measures of public and private action that have had a far-reaching and sometimes unstoppable impact. Once North Korea's $25 million deposit at the Banco Delta Asia became radioactive, no major power in the world could stop the dominoes from falling. Even though the six-part talks eventually resumed, the regime remains a financial leper. And in a world of nongovernmental organizations, galactic international corporate enterprises, stateless jihadists, and governments that must increasingly respond to balkanized local political voices, circumspect private action (albeit supported by credible and reliable financial intelligence supplied by state actors) taken by private international financial institutions may well prove as large a protector of freedom as it was once presumed to be a potential threat to national security. **TFL**

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Endnotes

[1]Significantly, freezing such property can last for decades. For example, billions of dollars of the Iraqi government's funds and parastatel funds were frozen during the first Gulf War in the early 1990s. Notwithstanding long-standing rights of set-off asserted by U.S. commercial banks, the funds remained frozen until the onset of the military operation in Iraq in 2002. At that time, under a little-known provision of Article III of the PATRIOT Act (which paralleled the TWEA), title to the suspended or frozen funds was transferred to and vested in the President. *See* 50 U.S.C. § 1702(1)C. Without need of recourse to run the usual traps of congressional appropriations, the President's power to apply such seized funds as he sees fit is plenary. The Iraqi money in question was quickly shrink-wrapped, packaged, and transported to Baghdad for distribution to Iraqi pensioners and government employees shortly after the fall of the city.

[2]In 2006 and 2007, the U.S. District Court for the Central District of California reviewed the Humanitarian Law Project's challenge to the constitutionality of the phrase "otherwise associated with." The plaintiffs were seeking to provide support to the nonviolent activities of otherwise designated terrorist groups and asserted that the language was unconstitutionally vague and was otherwise overbroad in limiting First Amendment rights to free association. In November 2006, the court sided with Humanitarian Law Project and held the provision to be unconstitutional. The Treasury Department quickly swung into action and issued defining regulations intended to address the constitutional infirmity. Upon reconsideration of the issue in April 2007, the court agreed with the department and held that Executive Order 13224 was constitutional as applied. *See Humanitarian Law Project v. U.S. Dept. of Treasury*, 484 F.Supp 2d 1099 (C.D. Cal. 2007).

[3]For a lucid and more specific accounting of the Iranian sanctions model and its interplay with the U.S. government's actions against North Korea and the BDA, *see* Rachel Loeffler, *Bank Shots—How the Financial System Can Isolate Rogues*, Foreign Affairs (March/April 2009).

[4]*Id.*