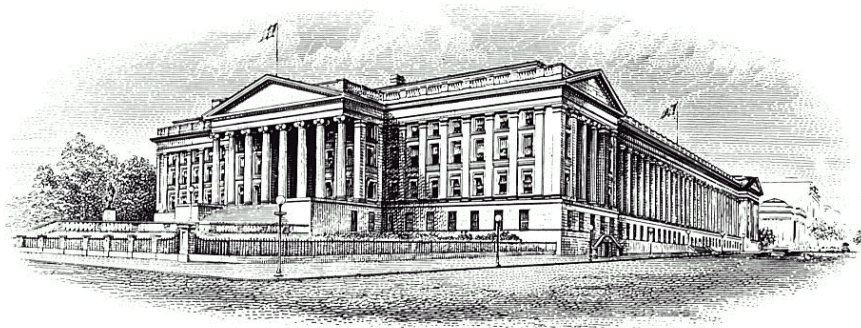




United States Department of the Treasury

**WRITTEN TESTIMONY OF
DAVID D. AUFHAUSER, GENERAL COUNSEL**

BEFORE THE

THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

SEPTEMBER 25, 2003

Chairman Shelby, Senator Sarbanes, and distinguished members of this Committee, thank you for inviting me to testify today about the United States Government's efforts generally, and the efforts of the Department of the Treasury in particular, to address the financing of terror.

Shortly after the September 11th attacks, President Bush gave those of us who work on these issues very clear orders. He told us to starve the terrorists of funding. Since that mandate over two years ago, the United States has waged a "war" against global terrorism. We at Treasury are principally involved in the financial front of that "war." But this "war" is profoundly uncommon. There is no known sovereign; no uniformed army; no hill to take; no target that is seemingly out of bounds. Indeed, terrorists obscenely place a premium upon the

death of innocents. It is shadow warfare, and a key source of the stealth and mobility necessary to wage the war is money.

Money is the fuel for the enterprise of terror. It may also be its Achilles' heel. It can leave a signature, an audit trail, which, once discovered, might well prove the best single means of identification and capture of terrorists and pinpointing their donors. Financial records are literally the diaries of terror. Stopping the flow of money to terrorists may be one of the very best ways we have of stopping terror altogether. That is a dramatic statement, but it is not possible to overstate the importance of the campaign against terrorist financing. If you follow and stop the money, you have gone a long way to diminish the killing and destruction.

That being said, it is unwise to understate the difficulty of this endeavor. Our economy is deliberately open and porous. The ways to game restrictions on the flow of capital within the banking system are nearly infinite, and the endeavor becomes more difficult when money is moved outside the banking system. Moreover, the challenge is worldwide in scope. The overwhelming bulk of the assets we seek to freeze; the cash flow that we hope to strangle; and the records that we aspire to exploit are beyond the oceans that surround us. To act alone would justly invite critique.

In the United States, the program to wage the financial front of the war includes:

- (i) an Executive Order using the powers granted by the Congress through the International Emergency Economic Powers Act that raises the standards of conduct and due diligence of financial intermediaries, and explicitly targets underwriters of terror for the freezing of their assets;
- (ii) UN Security Council resolutions and conventions that internationalize asset freezes and mandate the criminalization of terrorist financing;

- (iii) more scrutiny at the gateway to U.S. financial markets that has been provided under the USA PATRIOT Act;
- (iv) law enforcement criminal investigations and foreign intelligence operations aimed at terrorist supporters and terrorist financiers;
- (v) extensive diplomatic efforts, including the engagement of central bankers and finance ministries, to champion the need and wisdom for international vigilance against terrorist financing and the taking of appropriate action to address it;
- (vi) outreach to the private sector for assistance in the identification, location and apprehension of terrorists and their bankers; and,
- (vii) bilateral and multilateral efforts to build laws and systems that will help prevent terrorists from corrupting the financial system in developing countries around the globe, followed by training missions dispatched to those countries to help their officials administer those laws.

Perhaps the most visible weapon on the financial front of the war has been the public designation of terrorists and their support network coupled with the freezing of their assets. Publicly designating terrorists, terrorist supporters and facilitators, and blocking their abilities to receive and move funds through the world's financial system have been, and continue to be, a crucial component in the fight against terrorism. The Executive Order imposing economic sanctions under the International Emergency Economic Powers Act permits the public designation of not only terrorists and terrorist organizations, but also supporters, facilitators and underwriters of terror as well. Once designated, this order freezes the assets of the designee held by U.S. persons. Action under this order is not "criminal" and does not require proof beyond a reasonable doubt. Currently, we have publicly designated 321 individuals and entities as

terrorists or terrorist supporters and over \$136.8 million dollars have been frozen around the world.

This is not, however, a “box score” game. Only a small measure of success in the campaign is counted in the dollars of frozen accounts. The larger balance is found in the wariness, caution, and apprehension of donors; in the renunciation of any immunity for fiduciaries and financial intermediaries who seek refuge in notions of benign neglect and discretion, rather than vigilance; in financial pipelines that have gone dry; in the flight to old ways of value transfer, such as the use of cash couriers, in the ability to focus our resources on those avenues of last resort; and in the gnawing awareness on the part of those who bank terror that the symmetry of borderless war means that there is no place to hide the capital that underwrites terror.

Notwithstanding the power of this tool, it is important to remember that it is only potent when we can pull the rest of the world with us, through coordinated multilateral action, in identifying and freezing the assets of identified terrorists and their supporters. The simple fact is that most of the funds we are attempting to freeze are beyond the reach of the United States. Acting unilaterally is often an empty gesture; an action without effect. Therefore, we need our allies to join with us and act in concert and in a coordinated way. This is no easy task. And this is a task that occupies much of our time on the financial front of the war against terrorism. The most critical aspect of this task is the ability to develop and provide our allies in the war with sufficient actionable information – information that is often thin and also derived from extremely sensitive sources. The predicate for everything we do is actionable information about a target.

Organization of the Effort

Shortly after the attacks of September 11, in furtherance of developing and implementing a coordinated attack on terrorist financing, the National Security Council established a Policy Coordinating Committee on Terrorist Financing. The purpose of the Committee is to (i) recommend strategic policy direction to the National Security Council on issues relating to terrorist financing; (ii) vet and approve proposed public action against targeted terrorists and terrorist financiers; and (iii) coordinate the United States' efforts on issues relating to terrorist financing. I have chaired that Committee since October 2001.

The Committee has sufficient structure to ensure we are working toward achieving the goals of the committee; however, we have purposefully kept the process flexible, informal, collaborative and iterative. It is a process that has worked well to vet and coordinate proposed action by the United States on the financial front of the war on terrorism.

Challenges Ahead

1. The Kingdom of Saudi Arabia. I have testified before that Saudi Arabia has been an “epicenter” of terrorist financing. Financing emanating from Saudi Arabia and a balance of Gulf States has been a central focus of our efforts at collection and prevention. The Saudi Government has taken action and implemented systemic changes – both before and after the May 12th bombings in Riyadh – that are promising and constructive. More initiative, follow-through on systemic change, and personal accountability are required.

The May 12th bombings in Riyadh appear to have given life to such a sea change. A sense of urgency now informs Saudi efforts. The promising change on the financial front of the war is the agreement to create a Joint Task Force with the United States to investigate terrorist financing and follow financial leads. The dialogue and dynamic in this task force will be “cop to cop” – taking place on the ground rather than between diplomats at 30,000 feet. The task force

will share financial leads on a real time basis and begin meaningful – and hopefully productive – investigations to track down the “banking of terror.” This will be an important proving ground to determine Saudi commitment on the financial front of the war. We must watch diligently as the task force is established and moves forward.

2. HAMAS, etc. We must continue to focus our resources on HAMAS and similar terrorist organizations. We must work as hard as we can to convince the rest of the world that it cannot stand by and do nothing against groups that are sending suicide bombers onto buses or into plazas to kill innocent children. Unlike al-Qa’ida, we do not enjoy a UN Sanctions program mandating the freezing of these organizations’ and their operatives’ and supporters’ assets. What is required is unrelenting, consistent, well-informed diplomatic outreach using well developed facts – actionable intelligence – to bring a principled discipline to countries that now stand on the sideline refusing to act because the purpose of acts of terror are believed to be politically laudable, notwithstanding the moral obscenity of the means of reaching any such goal.

3. Global Systemic Change. We must continue to work bilaterally and multilaterally to build financial safeguards throughout the globe to do all we can to ensure terrorists cannot game the financial system. Charities and informal money transfer operations, or hawalas, are of particular concern. We have done much in this area, but we need to continue to do more.

4. Address Root Causes. In the long run, the war on terror will be like Sisyphus toiling to push the stone up the hill if the community of nations does not do something to address the despair and economic misery that permits false prophets to preach hate and killing and terror as remedy.

Those are some of the more significant challenges we see as we move forward on the financial front of the war. We have come a long way, but we have a long way to go. The

President has said on many occasions that this will be a long battle. I can validate that statement. But you should know I see tremendous commitment to this battle every day.

Because of this Committee's jurisdiction, we think it is important to spend some time discussing what we have done with the tools the Congress provided to us nearly two years ago in the USA PATRIOT Act.

The Role of the Anti-Money Laundering Regulatory Regime in the Financial War on Terrorism

After the attacks of September 11th, it seemed as if we were looking at the world through the wrong end of a telescope. Worldwide efforts to combat money laundering were focused, rightly so, on identifying large scale criminal enterprises that were injecting millions of dollars into the financial system. In the world of the financing of terrorism, however, we were reminded that the deadliest of operations can be financed with relatively paltry sums of money that would give even the best of financial institutions not the slightest hint of their illicit purpose. An integral part of the financial war on terrorism over the past two years has focused on enhancing the ability of financial institutions to better identify and guard against the financing of terrorism. The first step, however, is recognizing our limitations. We are still discovering the many different ways in which our enemies use the recorded financial system to fund their operations. While we have developed considerable information on their methods, we still have much to learn.

This we do know – even the most unsophisticated of terrorism financing operations will likely intersect the regulated financial system at some point. Title III of the USA PATRIOT Act mandates many substantial changes to the United States anti-money laundering regulatory regime. We wish to thank this Committee for its work in developing and securing passage of these provisions. Title III, in our view, reflects the realities of today's global financial

marketplace and the new threats to our financial system. As you know, for the past two years we have been engaged in the most extensive revision of the anti-money laundering regulatory regime in recent memory.

Once complete, if properly enforced, these changes will go far to prevent not only the laundering of illicit proceeds, but also aid the financial system in preventing the use of clean money to finance terror. The Act's principal focus on financial intermediaries, the international gateways to the US financial system, the expansion of due diligence and monitoring requirements, enhanced reporting obligations, and renewed commitment to information sharing comprise the elements of a comprehensive anti-terrorist financing regime. While the end goal of devising systems capable of proactively identifying potential terrorist financing activities remains elusive, we are creating the necessary infrastructure within financial institutions that will one day support such systems. For example, several sections of the Act focus on the correspondent account, the international gateway to the US financial system. These provisions require financial institutions to conduct greater due diligence both before opening such accounts and while they are open. The scrutiny given to these accounts not only augments the audit trail, but also serves to deny certain foreign financial institutions access to the US financial system in the first place. Uniform customer identification regulations recently issued will require all financial institutions to take important steps to verify the identity of their customers. Additionally, we have created a system pursuant to section 314(a) of the Act to enable law enforcement to locate quickly the accounts and transactions of those suspected of money laundering or the financing of terrorism. While we are still working closely with law enforcement and the financial community on the operation of the system, since its creation, the system has been used to send the names of 256 persons suspected of terrorism financing to

financial institutions. This has resulted in 1,739 matches that were passed on to law enforcement.

A particularly important provision is Section 311 of the Act, which provides the Secretary with the necessary ability to protect the US financial system against specific terrorist financing threats posed by foreign financial institutions, accounts, transactions, or even entire jurisdictions. The Secretary can require US financial institutions to take appropriate countermeasures against such threats, countermeasures which include requiring the termination of any correspondent accounts involving the threat. We have utilized this authority in the money laundering context, and we are presently considering its use in connection with the financing of terrorism.

I thought it would be helpful to bring you up-to-date on where we are in the process of implementing Title III of the Act. Since its passage, Treasury, the Financial Crimes Enforcement Network (FinCEN), the financial regulators, and the Department of Justice have worked together to draft and issue extensive regulations that implement the Act's provisions. Among other things, we have published regulations that --

- (i) Permit and facilitate the sharing of critical information between law enforcement and the financial community, as well as among financial institutions themselves;
- (ii) Close off our financial borders to foreign shell banks, require additional due diligence for correspondent accounts maintained for foreign financial institutions, and require foreign banks with correspondent accounts in the United States to supply the name of a US agent for service of process as well as the identities of their owners;
- (iii) Require US financial institutions to establish customer identification and verification procedures for all new accountholders;

- (iv) Expand the universe of financial institutions reporting potentially suspicious activities to FinCEN; and
- (v) Expand our basic anti-money laundering regime to include a wide range of financial service providers, such as the securities and futures industry and money services businesses.

Our work is not yet finished. We are working to complete several regulatory packages. First on the list is the issuance of a final regulation that will delineate the scope of the obligation of US financial institutions to conduct due diligence and enhanced due diligence on correspondent accounts maintained for foreign financial institutions and private banking accounts for high net worth foreign individuals. Although the banking, securities, and futures industries have been operating under an interim rule since last year, important questions regarding the application of this statutory provision remain.

We will also complete final regulations requiring other categories of financial institutions, such as those in the insurance and hedge fund industries, to establish anti-money laundering programs. This is an integral component of our anti-money laundering and anti-terrorist financing efforts – to ensure that all available avenues for financial crime are blocked by this basic protection. Similarly, now that we have issued final regulations requiring the banking, securities, futures, and mutual fund industries to establish customer identification programs, we will be drafting regulations applicable to financial institutions in other industries that offer their customers accounts. Finally, we are continuing to explore the appropriate expansion of the suspicious activity reporting regulations to additional categories of financial institutions. We have already proposed to require mutual funds, futures commission merchants, and insurance companies to file such reports.

Let me provide you with some sense of how we are using the USA PATRIOT Act and the implementing regulations to combat terrorist financing. While it is still relatively premature to evaluate their impact, we do have some indication of their effectiveness. For example, as I noted above, the section 314(a) system has been used in many cases and has resulted in a substantial number of leads. The additional reporting and recordkeeping authorities have enhanced the database FinCEN uses for its research and analysis in supporting terrorism investigations – since September 11th, FinCEN has supported 2,692 terrorism investigations. The Terror Hotline established by FinCEN has resulted in 789 tips passed on to law enforcement. Since the World Trade Center Attacks, FinCEN has made 519 proactive case referrals to law enforcement based upon an analysis of information in the Bank Secrecy Act database. With the expansion of the suspicious activity reporting regime, financial institutions have filed 2,655 suspicious activity reports (“SARs”) reporting possible terrorist financing. In addition to passing these reports on to law enforcement, FinCEN has and will continue to analyze the SARs to report on systemic patterns in the financing of terrorism.

Finally, I cannot neglect mentioning our partnership with the financial community. Since passage of the Act, the willingness of the financial community to work with us in this fight has been remarkable. Cooperation comes in the form of formal and informal feedback on new regulations, one-on-one assistance with specific investigations, and the proactive identification of potential instances of the movement of funds to finance terrorism. While we expect the financial community to join us in this fight -- and they have done so -- we also recognize and appreciate these efforts, from the largest of financial institutions to the smallest of the community banks.

While it is appropriate on this occasion to reflect on what we have accomplished, it is essential that we map out a strategy for proceeding. The plan is straightforward – do a better job

of leveraging the regulatory regime to maximize the protections against the financing of terrorism. We will do so in the following manner:

- *Better utilization of technology*

Technology holds one of the keys to our success in the financial war on terrorism. This involves the ability to marshal and synthesize all available information to proactively identify possible instances of the movement of illicit funds. Now more than ever we require our financial institutions to produce data and information. Several initiatives are already under way within Treasury and FinCEN. For example, FinCEN will be receiving assistance from the Business Executives for National Security and the Wharton School of the University of Pennsylvania in developing technology that will allow financial institutions to report suspicious transactions more easily and quickly. As part of an overall plan to enhance our technological platform, FinCEN is also developing a new system to manage the Bank Secrecy Act (“BSA”) database. “BSA Direct” will involve a significant upgrade to the platform on which the BSA database is maintained, and will provide users with web-based, secure access that allows for faster and easier searching. Finally, we will continue to work to assist financial institutions in developing proactive software to better identify potential terrorist financing activities.

- *Increased Information Sharing*

A central theme of the USA PATRIOT Act is enhanced information sharing. While we have taken substantial steps toward this goal, our challenge remains to find better ways of providing information and feedback. This is not simple. Often the information we develop is highly protected intelligence information that cannot be disclosed, and we are always wary of providing our enemies with a roadmap or a “how-to” guide to manipulating our defenses. That

said, we understand the importance of, and are searching for, better ways to share information with the private sector.

- *Developing Similar International Standards*

For our regulatory efforts to be effective, standards should be internationalized as much as possible. Thus, we will continue to devote ourselves to encouraging the development of international money laundering and terrorism financing standards that reflect the principles of our domestic regime. We have already done this in several areas. In conjunction with the Financial Action Task Force, in addition to securing the promulgation of the Eight Special Recommendations on Terrorist Financing, the FATF recently completed the revision of the 40 Recommendations on Money Laundering. The changes reflect many of the concepts of the USA PATRIOT Act. For example, key changes to the 40 Recommendations include: (1) enhanced due diligence with respect to correspondent banking accounts; (2) increased scrutiny for politically exposed persons; and (3) prohibition on the use of shell banks.

- *Ensuring Compliance with International Standards*

Assessing jurisdictions against these standards and cultivating their compliance with them are important components of our work. Without vigorous and consistent implementation of these standards throughout the globe, terrorists and criminals will enter the international financial system at the point of least resistance, and preventive national efforts will be rendered considerably less effective. Ensuring global compliance with international standards is accomplished through a three-prong strategy that includes: (i) objectively assessing every country's standards against the international standards; (ii) providing capacity-building assistance for key countries in need; and (iii) ensuring appropriate consequences for countries

and institutions that fail to take reasonable steps to implement standards to prevent terrorist financing and money laundering.

Treasury is participating in a variety of global assessments sponsored by the IMF and the World Bank, the FATF, and FATF-Style Regional Bodies. We are also seeking to build the capacity of jurisdictions to combat money laundering and the financing of terrorism through a robust regulatory regime. This is done through bilateral and multilateral outreach and training. Finally, recalcitrant jurisdictions face potential sanctions pursuant to section 311 of the USA PATRIOT Act.

- *Evaluating the US Regulatory Regime*

As we complete regulations implementing the USA PATRIOT Act, our next and perhaps most important task is to take a critical look at what we have done and ask the difficult questions of whether they are effective and what additional regulations may be necessary. We will work through both formal and informal means to conduct this evaluation, and look forward to working with this Committee during the process.

We are, in our judgment, on the right path. We have much work left to do. We appreciate the support we have received from the Congress – particularly this Committee – on these important issues. I believe what I have said time and again, stopping the flow of money is one of the very best ways to stop the terror.