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Hearing on

“Terrorist Funding: Kidnapping for Ransom, Antiquities, and Private Donors”

Before the Terrorism, Nonproliferation, and Trade Subcommittee

of the

House Foreign Affairs Committee

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Chairman Poe and Members of the Subcommittee on Terrorism, Nonproliferation and Trade;

Thank you for the opportunity to testify today. It is an honor for me to be here.

I retired after a 26 year career as a Case Officer for the Central Intelligence Agency and as a Special Agent for the U.S. Department of Treasury. I believe I am the only individual to have ever been both a covert Case Officer and a Treasury Special Agent.

Much of my career with Treasury was involved with combating international money laundering and terror finance. Since my retirement, I have been a contractor and consultant for a number of U.S. departments, agencies, and business enterprises. I have been fortunate to continue my domestic and international travels primarily providing training and technical assistance in financial crimes enforcement. I have written four books on money laundering and terror finance as well as numerous published articles. Additional information can be found on my website: www.JohnCassara.com

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“Without money, there is no terrorism.”

This simple truism was recognized early on. A few days after the deadliest terrorist attack in U.S. history, President George W. Bush stated, “Money is the lifeblood of terrorist operations. Today we are asking the world to stop payment.”

More than 14 years after the September 11 attacks, we are meeting here this afternoon in part to ask, "Has President Bush’s original request been fulfilled? Has the world stopped payment?"

Of course, the answer is not simple. Successful terrorist and organized criminal groups diversify their funding sources. Similarly, they diversify the ways they launder their money. Our adversaries are creative and they adapt.

This afternoon, I would like to talk about an increasingly troublesome source of funding – kidnapping, ransom and extortion sometimes known by its acronym KRE.

I would then like to briefly discuss two other related money laundering and terror finance methodologies: trade-based money laundering (TBML) and underground financial systems. Both are loosely tied to KRE.

Kidnapping for ransom is a crime as old as antiquity. In recent years, terrorist and associated organized criminal organizations have turned to kidnapping as a relatively easy and lucrative source of funding. The United Nations feels the problem is growing. The UN estimates that approximately \$120 million in ransom payments was paid to terrorist groups alone between 2004 and 2012.ⁱ And according to a 2012 assessment by David S. Cohen, the Treasury Under Secretary for Terrorism and Finance Intelligence, kidnapping for ransom is our most significant terrorist financing threat today.ⁱⁱ

In 2014, 35 percent of kidnappings were in Asia, followed by Africa at 30 percent, the Americas with 21 percent, the Middle East with 12 percent and Europe/Russia with 2 percent.ⁱⁱⁱ

We are all concerned about the growth and savagery of the Islamic State of Iraq and the Levant (ISIS). The terror organization has kidnapped multi-hundreds if not thousands of victims, including local Iraqis, Syrians and members of ethnic minorities, as well as Westerners, and East Asians located in the region. Some were used to extract ransom payments, and others were brutally murdered to send a political message. Because kidnapping is both profitable and valuable as a propaganda tool, ISIS has reportedly purchased Western hostages from moderate rebels at border exchanges. According to a Financial Action Task Force (FATF) assessment, in 2014 ISIS raised approximately \$20 - \$45 million from kidnapping for ransom.^{iv}

Foreign nationals taken hostage worldwide vary from aid workers to tourists, from employees of private companies to diplomats or other government officials. Americans are not immune. Although an estimated 60 – 70 percent of overseas kidnapping of U.S. citizens goes unreported, last year, according to the Bureau of Consular Affairs at the State Department, more than two dozen Americans working in private industry were kidnapped in terrorism-related incidents.^v

Demands may also be evolving beyond ransoms to extortion and protection money. One Al-Qaeda affiliate was planning to extort substantial annual payments, amounting to millions of euros a year, from a European-based company, in exchange for a promise not to target that company's interests in Africa. And extortion is^{vi} often used by terrorist groups in the extraction industry such as oil and minerals, agriculture, various production facilities, cultural artefacts, etc.

In Southeast Asia, piracy at sea is reaching record levels.^{vii} By using tactics such as extortion and shakedowns, terrorist organizations are following the playbook of organized crime.

Because kidnapping and associated crimes have been so successful, it appears the average ransom payment is increasing. It is a vicious cycle. There is no doubt that ransom payments lead to future kidnappings, and future kidnappings lead to additional ransom payments. And, of course, the ransom payments build the capacity of terrorist organizations which in turn fuels additional terrorist attacks.

Logically, we must do what President Bush urged: “Ask the world to stop payment.”

To this end, there have been several United Nations Security Council Resolutions (UNSCRs), including 2133 (2014) and 2170 (2014) that call on member states to prevent terrorists from benefitting, directly or indirectly from ransom payments. UNSCR 2161 (2014) confirms that the prohibition on providing funds to individuals and entities on the al-Qaida Sanctions List, including ISIS, also applies to the payment of ransoms to individuals, groups, or entities on the list, regardless of how or by whom the ransom is paid. Thus 2161 applies to both direct and indirect ransom payments through multiple intermediaries. The restrictions cover not only the ultimate payer of the ransom, but also the parties that may mediate such transfers, including insurance companies, consultancies, and any other financial facilitators.^{viii}

Despite the restrictions, the world has not stopped payment. Reportedly, even some governments have rewarded terrorists with ransom payments. But of course, the complicating factor is our humanity. It is difficult to turn away from the anguished cries of those kidnapped and the frantic appeals of their loved ones.

ISIS, Al-Qaeda in the Lands of the Islamic Maghreb (AQIM), Al-Qaeda in the Arabian Peninsula (AQAP), the Taliban in Pakistan and Afghanistan, Abu Sayyaf, Boko Haram and dozens of other lesser known groups - sometimes in coordination with local criminals – use a variety of funding methods. Generally speaking they keep their money within their networks and have relatively little interaction or reliance on international financial systems. That is why our financial countermeasures such as financial intelligence, sanctions, and designations are for the most part ineffective against terror groups. I explain this in my book *Hide & Seek: Intelligence, Law Enforcement and the Stalled War on Terror Finance* (2006, Potomac Books).

These groups and others like them often use cash, gold, and traditional, ethnic-based or cultural systems such as hawala and trade-based money laundering and value transfer. Although open source reporting is sketchy, these informal systems are all believed to be used in KRE.

The FATF defines TBML as “the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origins.”^{ix} In relation to terror-finance, TBML takes a wide variety of forms. For example, it could be simple barter or a commodity-for-commodity exchange. In certain parts of Afghanistan and Pakistan, for

example, the going rate for a kilo of heroin is a television set. Drug warlords exchange one commodity they control (opium) for others that they desire (luxury and sports utility vehicles). However, generally speaking, money laundering and value transfer through simple invoice fraud and manipulation are most common. The key element is the misrepresentation of the trade good to transfer value between importer and exporter. The quantity, quality, and description of the trade goods can be manipulated. The shipment of the actual goods and the accompanying documentation provide cover for “payment” or the transfer of money. The manipulation often occurs either through over-or under-valuation - depending on the objective to be achieved. To move money out of a country, participants import goods at overvalued prices or export goods at undervalued prices. To move money into a country, participants import goods at undervalued prices or export goods at overvalued prices. For the most part, all of this avoids countries' financial intelligence reporting requirements. Trade-based value transfer is found in every country around the world.

Trade-based value transfer has existed long before the advent of modern “Western” banking. In areas where our adversaries operate, trade-based value transfer is part of a way of life. It is part of their culture; a way of doing business.

In addition to customs fraud, trade-based value transfer is often used to provide “counter-valuation” or a way of balancing the books in many global underground financial systems - including some that have been used to finance terror. Trade-based value transfer is found in hawala networks, most other regional "alternative remittance systems," the massive underground Chinese fei-chien “flying money system,” the misuse of the Afghan Transit Trade, Iran/Dubai commercial connections, suspect international Lebanese/Hezbollah trading syndicates, non-banked lawless regimes such those in Somalia and Libya, and many more.

The magnitude of the problem is staggering. The World Bank estimates that global remittances through official channels like banks and Western Union will reach \$707 billion by 2016.^x Unofficially, nobody knows. However, the International Monetary Fund believes, “unrecorded flows through informal channels are believed to be at least 50 percent larger than recorded flows.”^{xi} According to these World Bank and IMF estimates, unofficial remittances are enormous! Yet we continue to ignore trade’s role in underground financial systems.

Trade and underground finance are part of the kidnap for ransom equation. For example, money and value transfer services are found throughout Iraq and Syria, including in areas where ISIS operates. These financial companies or hawaladars are trusted brokers that have established relationships throughout the region, which allow them to “transfer” funds to finance trade and pay remittances, and other financial activities. Many are family, clan, or tribe centric. They operate on trust and secrecy. These money and value transfer service (MVTs) companies do not conduct electronic funds transfers as banks do but rather communicate via email, fax, or phone with a local or foreign associate to pay or receive payment from the counterparty to a transaction. The MVTs companies then settle their business at a later date, including physical cash payments

or via the conventional banking system. I believe we will also be seeing the increasing use of cyber currencies to settle accounts. However, I want to again repeat and emphasize a fact that is continually overlooked; historically and culturally, in all of the areas of the world where our terrorist adversaries operate, trade is used to balance the books or settle accounts. This is often done by the process of over-or-under invoicing sometimes called “counter-valuation.” For example, that is why many hawaladars have direct or indirect ties to import/export or trading companies. Examining related trading records for invoice fraud and value transfer could be the backdoor into money/value transfer systems. Unfortunately, neither the United States nor our partners are doing this.

The FATF states that TBML is one of the three largest money laundering methodologies in the world.^{xii} (Money laundering through financial institutions and bulk cash smuggling are the other two).

I would like to give you just a few examples of the magnitude of the problem.

Dr. John Zdanowicz, an academic and early pioneer in the field of TBML, examined 2013 U.S. trade data primarily obtained from the U.S. Census Bureau. By examining under-valued exports (\$124,116,420,714) and over-valued imports (\$94,796,135,280) Dr. Zdanowicz found that \$218,912,555,994 was moved out of the United States in the form of value transfer! That figure represents 5.69% of U.S. trade. Examining over-valued exports (\$68,332,594,940) and under-valued imports (\$272,753,571,621), Dr. Zdanowicz calculates that \$341,086,166,561 was moved into the United States! That figure represents 8.87% of U.S. trade in 2013.^{xiii}

I believe the United States has one of the most robust customs enforcement arms around the world. So if almost 6 – 9 percent of our trade is tainted by customs fraud and perhaps trade-based money laundering, what does that mean for the rest of the world – particularly in areas of weak governance and high corruption like areas where our adversaries operate?

In another example, Global Financial Integrity (GFI), a Washington, D.C.-based non-profit, has done considerable work in examining trade-misinvoicing. It is a method for moving money illicitly across borders, which involves deliberately misreporting the value of a commercial transaction on an invoice and other documents submitted to customs. It is a form of trade-based money laundering. In a 2014 study, GFI found that the developing world lost \$6.6 trillion in illicit financial flows from 2003 to 2012, with illicit outflows alarmingly increasing at an average rate of more than approximately 9.4 percent per year.^{xiv} The number is now approaching \$1 trillion a year hemorrhaging from the developing world via trade-misinvoicing alone!^{xv}

As noted, other forms of TBML include barter trade, capital flight, tax evasion, informal value transfer systems (such as hawala), various forms of commercial fraud and trade-misinvoicing and criminal trade-based money laundering.

I have conducted numerous investigations and written extensively about TBML. Last week, a new book that I wrote was released; *Trade-Based Money Laundering: The Next Frontier in International Money Laundering Enforcement* (Wiley). In the book, I make the argument that if one includes all its varied forms, trade-based money laundering could well be the largest money laundering methodology in the world. And, unfortunately, it is also the least understood, recognized, and enforced.

I urge the subcommittee on Terrorism, Nonproliferation, and Trade to further examine TBML. There are compelling reasons to do so. A systematic crack down on trade-fraud in the United States could possibly recover hundreds of billions of dollars a year alone in lost revenue. Perhaps more importantly, increased trade transparency will better secure the homeland and could be our most effective back door into underground finance.

In *Trade-Based Money Laundering*, I detail a number of recommendations and “steps forward.”^{xvi} I will briefly summarize a few of them:

1. As noted, I believe TBML could be the largest and most pervasive money laundering methodology in the world. However, we do not know for certain because the issue has never been systematically examined. This is even more surprising in the United States because annually we are possibly losing billions of dollars in lost taxes due to trade-mispricing alone. While not necessarily true for all money laundering methodologies, trade generates data. I believe it is possible for economists, statisticians, and analysts to come up with a fairly accurate estimate of the overall magnitude of global TBML and value transfer. Narrowing it down to specific problematic countries is easier still.

I suggest this subcommittee urge the Department of Treasury’s Office of Intelligence and Analysis (OIA) to at least examine U.S. related data and come up with an official estimate for the amount of TBML that impacts the U.S. A generally accepted estimate of the magnitude of TBML in all its varied forms is important for a number of reasons: a.) It will provide clarity; b.) It will focus attention on the issue; c.) From an enforcement perspective, the supporting analysis should provide both excellent insight into specific areas where criminals are vulnerable and promising opportunities for targeting; and d.) A systematic crack down on TBML and customs fraud will translate into enormous revenue gain for the governments involved.

2. In the world of anti-money laundering/counter-terrorist finance (AML/CFT), the FATF makes things happen. The FATF recognizes TBML is a huge concern. There is a special FATF typology report on TBML. However, in 2012 when the current FATF recommendations were reviewed and promulgated, TBML was not specifically addressed. It is past time this is done. I suggest this subcommittee contact the U.S. Department of Treasury (which heads the U.S. FATF delegation) and urge that the U.S.

introduce a resolution calling for the misuse of trade to launder money and transfer value to be examined as a possible new FATF recommendation.

3. I agree wholeheartedly with Raymond Baker of Global Financial Integrity that, “We cannot succeed in stopping the criminals while at the same time telling multinational corporations that they can continue to mis-invoice as they choose.” Abusive and fraudulent pricing techniques are used every day by thousands of multi-national corporations around the world to move money and transfer value across borders. Current AML/CFT countermeasures turn a blind eye to the use of “legitimate” actors’ use of shadow financial systems, questionable financial flows, offshore havens, and assorted grey techniques used for the purposes of tax evasion, wealth preservation, and increasing profits. Yet at the same time, authorities will aggressively pursue criminal organizations’ use of the same techniques to move tainted money across borders. This type of intellectual and political disingenuousness and hypocrisy contributes to our underwhelming success in effectively combating money laundering and other types of financial crimes. Global corporations must embrace legitimate trade. Legitimate actors should demand trade transparency. This means respecting customs duties, VAT assessments, currency exchange regulations, AML/CFT regulations, etc. I urge Congress to work to define illicit commercial financial flows that are facilitated via trade and then create effective and enforceable measures to curtail them. These needed reforms will also add revenue.

4. Trade transparency is the single best measure to detect trade-based money laundering and associated crimes. It is something that every government and legitimate industry and trader should welcome. Discounting the unattainable, by using modern analytic tools to exploit a variety of relevant big data sets, I believe international trade transparency is theoretically achievable or certainly possible at a factor many times over what we have today. All countries track what comes in and what goes out for security, statistical and revenue purposes. So by examining and comparing one country’s targeted exports with the corresponding trading partner’s record of imports it is a fairly straight forward process to spot anomalies. Some trade irregularities can be easily dismissed as numerical outliers. But sometimes anomalies can be indicative of customs fraud, tax evasion, value transfer, TBML, or perhaps even underground financial systems such as hawala that are used in kidnap for ransom.

In 2004, the United States government adopted a proposal I advanced and created the world’s first trade transparency unit (TTU). It is located within Homeland Security Investigations. Per the above, the TTU uses trade data and other data to identify suspect transactions. Since that time, about a dozen other countries have established similar units and over a billion dollars of cash and assets have been seized. The creation of TTUs has

simultaneously overlapped with exponential advances in big data and advanced analytics. Overlaying financial intelligence, law enforcement and customs data, travel data, commercial records, etc. further increases transparency and facilitates more precise targeting. And via customs-to-customs agreements, TTUs are able to exchange specific information about suspect transactions.

As I have discussed, in addition to being an innovative countermeasure to TBML and value transfer, combatting trade-fraud is a revenue enhancer for participating governments. Frankly, it is for this reason that many countries have expressed interest in the concept.

I urge Congress to fully fund the TTU initiative so as to promote its expansion. Moreover, the concept of trade transparency should be built into the US trade agenda. For example, the new Trans-Pacific Partnership (TPP) is set to lower or eliminate tariffs on everything from imported Japanese cars to New Zealand lamb, while opening two-fifths of the global economy to easier trade in services and electronic commerce.^{xvii} I don't have a position on the pros and cons of the TPP. But the volume of the increased trade will provide increasing opportunities for trade-based value transfer and money laundering. I suggest we help protect abuse by insuring that every TPP signatory country establish a TTU and share appropriate targeted trade data to spot anomalies that could be indicative of trade fraud at best and TBML at worst.

I appreciate the opportunity to appear before you today and I'm happy to answer any questions you may have.

ⁱ Paul Adams, "Kidnap for Ransom by Extremist Groups Extracts High Price," BBC, 12 December, 2014; available online: <http://www.bbc.com/news/world-asia-30384160>

ⁱⁱ David S. Cohen, "Kidnapping for Ransom: The Growing Terrorist Financing Challenge," Chatham House, October 5, 2012; available online: <https://www.chathamhouse.org/sites/files/chathamhouse/public/Meetings/Meeting%20Transcripts/051012Cohen.pdf>

ⁱⁱⁱ Neil Young & Associates International (NYA International) as quoted by Dina Gusovsky, "The Multibillion Dollar Business of Ransom," CNBC, July 7, 2015; available online: <http://www.cnbc.com/2015/07/06/the-multi-million-dollar-business-of-ransom-.html>

^{iv} "Financing of the Terrorist Organization Islamic State in Iraq and the Levant," The Financial Action Task Force (FATF), February, 2015, p. 18; available online: <http://www.fatf-gafi.org/media/fatf/documents/reports/Financing-of-the-terrorist-organisation-ISIL.pdf>

^v Bureau of Consular Affairs, U.S. Department of State, as quoted by Dina Gusovsky.

^{vi} David Cohen

^{vii} Luke Graham, "Piracy Increases 22% in Southeast Asia," CNBC, July 9, 2012; available online: <http://www.cnbc.com/2015/07/09/piracy-increases-by-22-in-southeast-asia.html>

^{viii} FATF

^{ix} "Trade-Based Money Laundering, the FATF, Executive Summary, June 23, 2006; available online:

<http://www.fatf-gafi.org/media/fatf/documents/reports/Trade%20Based%20Money%20Laundering.pdf>

^x “Developing Countries To Receive Over \$410 Billion in Remittances in 2013, Says World Bank,” World Bank Press Release, October 2, 2013; available online: (<http://www.worldbank.org/en/news/press-release/2013/10/02/developing-countries-remittances-2013-world-bank>)

^{xi} Dilip Ratha, “Remittances, Funds for the Folks Back Home,” International Monetary Fund; available online: (<http://www.imf.org/external/pubs/ft/fandd/basics/remitt.htm>)

^{xii} Trade-Based Money Laundering, the Financial Action Task Force (FATF) 2006, p. Executive Summary; available online: <http://www.fatf-gafi.org/publications/methodsandtrends/documents/trade-basedmoneylaundering.html>

^{xiii} Analysis given to the author by Dr. John Zdanowicz via June 30, 2015 email

^{xiv} “New Study: Crime, Corruption, Tax Evasion Drained a Record US\$991.2bn in Illicit Financial Flows from Developing Economies in 2012,” Global Financial Integrity; December 15, 2014, available online: <http://www.gfintegrity.org/press-release/new-study-crime-corruption-tax-evasion-drained-a-record-us991-2-billion-in-illicit-financial-flows-from-developing-economies-in-2012/>

^{xv} Raymond Baker, Global Financial Integrity, Seminar on “Illicit Financial Flows: The Most Damaging Economic Problem Facing the Developing World,” September 21, 2015 at the National Press Club, Washington, D.C.

^{xvi} John Cassara, *Trade-Based Money Laundering: The Next Frontier in International Money Laundering Enforcement*, Wiley, Hoboken, New Jersey, 2015; see chapter 11, pages 177 – 194.

^{xvii} William Mauldin, “Details of Pacific Trade Pact Fuel Debate,” *Wall Street Journal*, November 5, 2015; available online: <http://www.wsj.com/articles/pacific-trade-agreement-terms-herald-public-battle-1446712646>