

Money Laundering and Financing of Terrorism

C. Mallada Fernández

Abstract—Economic development and globalization of international markets have created a favourable atmosphere for the emergence of new forms of crime such as money laundering or financing of terrorism, which may contribute to destabilized and damage economic systems. In particular, money laundering have acquired great importance since the 11S attacks, what has caused on the one hand, the establishment and development of preventive measures and, on the other hand, a progressive hardening of penal measures. Since then, the regulations imposed to fight against money laundering have been viewed as key components also in the fight against terrorist financing. Terrorism, at the beginning, was a “national” crime connected with internal problems of the State (for instance the RAF in Germany or ETA in Spain) but in the last 20 years has started to be an international problem that is connected with the defence and security of the States. Therefore, the new strategic concept for the defense and security of NATO has a comprehensive list of security threats to the Alliance, such as terrorism, international instability, money laundering or attacks on cyberspace, among others. With this new concept, money laundering and terrorism has become a priority in the national defense.

In this work we will analyze the methods to combat these new threats to the national security. We will study the preventive legislations to combat money laundering and financing of terrorism, the UIF that exchange information between States, and the hawala-Banking.

Keywords—Control of financial flows, money laundering, terrorism, financing of terrorism.

I. INTRODUCTION

THE topic of this work was chosen because money laundering and financing of terrorism have become an international problem in the last decades.

Money laundering has acquired great importance in the last two decades what has caused on the one hand, the establishment and development of preventive measures of money laundering and, on the other hand, a progressive hardening of penal measures.

In the last twenty years terrorism has undergone a great change and has grown from a domestic crime connected with internal problems of the State (as the RAF in Germany and ETA in Spain) to an international problem and connected with other crimes, as money laundering or tax evasion and with the defence and security of the States. Therefore, the new strategic concept for the defense and security of NATO has a comprehensive list of security threats to the Alliance, such as terrorism, international instability, money laundering or attacks on cyberspace, among others. With this new concept, money laundering and terrorism has become a priority in the national defense [10].

C. Mallada Fernández is Prof. Dr. Assistant in UDIMA University: Carretera de La Coruña, KM.38,500 Vía de Servicio, nº 15 28400, Madrid, Spain (e-mail: covadonga.mallada@udima.es).

The tragic events of 11 September were the crucial point in the development of new legislation to combat this new type of terrorism and money laundering. We will focus our study on Germany because in this State the legislation to combat terrorism had been marked by national terrorism in which the State could easily identifies the members who were part of the terrorism organization. Instead, nowadays Germany must face international terrorism in which is more difficult to locate the members of these organizations because they can be in any country and fully integrated into society without raising suspicions about their terrorist intentions. [4]

Each State has a different policy because the different criminal law regulations of each country are different and independent, so what it is money laundering and terrorism in one country is not in other country. In that way, governments, in order to fight and stop this delinquency need cooperation between each other and uniformity in the concept of these crimes. They must fight against such crimes through preventive legislation derived from European directives, since the exchange of tax information and prevention are the most important tools to eradicate financing of terrorism.

Moreover, with the rise of the preventive measures of money laundering in recent years, these types of criminals with large sums of capital have had to develop new techniques to achieve their purpose, to temper with money's apparent legality and use it in impunity. Consequently, money laundering and financing of terrorism techniques are highly sophisticated and equipped with a fast dynamics that allows them to be constantly adapting and changing in order to accomplish safe investments made up with funds of illicit origin. Rather than disguising criminal proceeds as legitimate funds, financing of terrorism seeks to disguise the origin of legitimate funds for use in terrorist activities. We will focus in this paper on the *hawalas*, methods use by al-Qaeda that in recent years is also being developed in Europe because of his informality. [20]

We begin our study with an introduction to domestic forms of terrorism both in Spain and Germany, then we will focus our attention in the current international terrorism, we will analyze the different methods of financing of terrorism (from legal and illegal sources); we will study money laundering to see the differences and similarities with financing of terrorism and we focus in particular in the “money laundering reverse”. Finally we will study the different methods to combat these types of crimes (Know your customer or exchange of information between FIU) and we will analyze the effective or effectiveness of using the same methods to combat money laundering and financing of terrorism.

The innovation and originality of this study are in the focus of the research. Nowadays financing of terrorism is not only a

criminal problem of one country, financing of terrorism is an international problem that uses the same skills of concealment as money laundering, and both are perpetrated across the tax havens, financial entities, etc. In that way, the Administration should fight against both crimes with the same weapons.

II. FINANCING OF TERRORISM

The issue of this paper is focused in the financing of terrorism. No terrorist organization can exist if they do not have economic sources to sustain their criminal activities. Terrorist financing has been a priority in the fight against terrorism, especially after the tragic events of 11 September. Therefore, we will focus on the study of the financing of terrorism as an autonomous crime of terrorism. [9]

The first problem that we must face in the study of terrorist financing is the lack of reliable data, we have hypothesis of the money that this crime moves but no real data, only approximation to the real data.

Then, we should analyze the difference between organized crime and terrorism. It is true that both phenomena have in common fundamental aspects and increase the chances of interaction between the two of them: both are moving in the underground, both avoid being controlled by authorities and both agree on the methods for achieving their goals. But organized crime seeks to obtain maximum economic benefit while terrorism rather uses that money as a way, not as an end. [11]

Once we have distinguished between organized crime and terrorism, we need to difference the means of funding for these organizations. We must emphasize that there is a before and after the Cold War. Traditionally, some States had collaborated with funding these terrorist organizations, but nowadays the sources of funding of these organizations can come from both legal and illegal sources. [17]

Legal sources can be voluntary financial contributions from supporters of the organization or forced contributions or money that comes from the business activities of the members of the organization. An important part of the financing of terrorist organizations as al-Qaida comes from charity. Thus, large Islamic charities have worked with this terrorist organization. This method of funding is so important that the government of United States has come to freeze funds of NGOs as Global Relief Foundation, Holy Land Foundation for Relief and Development, International Benevolence or Islamic American Relief Agency, among others. These hard measures have not been entirely successful, as they show that United States still are unaware of the main ways of financing these organizations, and have also helped to the resentment of the affected communities, since in some cases, the preventive measures taken by the US have been forced to close some of these organizations [8]

Illegal sources of funding may be the money that comes from crimes such as theft, extortion, kidnapping, the use of shell companies, or the case that concerns us in this paper, money laundering. [19]

The threats associated with money laundering and terrorist financing are constantly evolving, which requires regular

updates of the rules. Following the model of the fight against money laundering, international organizations as FATF and the European Directives, the EU Members have chosen to develop two different lines to combat terrorist financing [12], [13].

First, the preventive line, which, as well as in the fighting against money laundering, would be to establish a series of obligations for different entities (banks, casinos, lawyers....), through with which they should identify suspicious transactions; and secondly a repressive line, which would consist on the offenses specified in the Criminal Codes. [21]

Internal Market and Services Commissioner Michel Barnier said: "The Union is at the forefront of international efforts to combat the laundering of the proceeds of crime. Flows of dirty money can damage the stability and reputation of the financial sector, while terrorism shakes the very foundations of our society. In addition to the criminal law approach, a preventive effort via the financial system can help to stop money-laundering. Our aim is to propose clear rules that reinforce the vigilance by banks, lawyers, accountants and all other professional concerned" [1] So, preventive measures are the first step to fight against this delinquency and stop the flow of the illegal money.

III. INSTRUMENTS TO FIGHT AGAINST FINANCING OF TERRORISM AND MONEY LAUNDERING

The main international and European instruments against terrorist financing are the following [5]:

- International Convention for the Suppression of the Financing of Terrorism (1999)
- Resolution 1373 (2001) of the Security Council. According to this resolution, states must punish terrorist financing and assistance for terrorist activities.
- Europe Convention on the Suppression of Terrorism 1977 (amended in 2003)
- Council of European Convention on the Prevention of Terrorism (2005)
- Council of Europe Convention on Money Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism.
- Council Framework Decision of 13 June 2002 on combating terrorism.
- Directive 2005/60/EC on the prevention of the use of the financial system for money laundering and terrorist financing.
- 9 Special Recommendations FATF on Money Laundering & Terrorist Financing. [6] FATF/OECD (2010a) "FATF 40 recommendations, October 2003, incorporating all subsequent amendments until October 2004". [7]

In general, all the international instruments establish the need of the separate offense of the crime of financing of terrorism. It can be seen that preventive measures to combat the financing of terrorism are identical to those measures establish to fight against money laundering: Know your customer, keeping documents for 5-10 years (depends on the legislation of the country), etc.

The creation of the FIU (Fiscal International Unit) is one of the major instruments to combat these types of crimes. These units mainly analyze and transmitted to the competent authorities (or each other) information on suspicious activities of money laundering or terrorist financing [18]

The cell responsible for carrying out the terrorist attack of 11S was based in Hamburg. This fact made that the German government began to set up measures urgently, with the main purpose of preventing the commission of new terrorism attacks on German territory. Thus, after the 11S, two security packages were developed, one repressive and other preventive:

First Security Package (November 9, 2001). This package was repressive and included the following measures:

- a) Introduction of 129b StGB (Europeanization of criminal law). With the introduction of this provision, the German legislative intended to prosecute members of criminal organizations and terrorists once they were in Germany (although it was not necessary that they carried out a terrorist act).
- b) Forfeiture. One of the most important methods to fight against these crimes. To this end, paragraph 2 of Article 129b StGB provides that the confiscation will change under the terms established in paragraphs 73d and 74a StGB.
- c) Creation of the Evidence Central Auditors (*Kontenevidenzzentrale*). This measure should facilitate not only the discovery of transfers of funds aimed at financing terrorist activities but also those for money laundering.

Second Security Package: This package was preventive and established the *Terrorismusbekämpfungsgesetz* of 9 January 9 2002 which included the creation of the Joint Defence against Terrorism (*Gemeinsames Terrorismusabwehrzentrum*, GTAZ) in 2004, among other things. [16]

After the security packages new legislation was developed. For the purposes of this paper, we will mention the *Geldwäschekämpfungsgesetz* of 8 August 2002, with which the obligation of financial institutions to identify and report suspicious transactions was intensified and the creation of the BaFin (*Bundesanstalt für Finanzdienstleistungsaufsicht*) in 2003. BaFin tries to prevent any misuse of the financial system for the purposes of money laundering, terrorist financing and other crimes. For this purpose, BaFin ensures that the companies and persons under its supervision implement any statutory obligations adopted for prevent these crimes.

The problem is that the reforms carried out in Germany to combat money laundering in relation to the control of financial transactions cannot be used to combat against those terrorist that have a small budget for financing their criminal activities or those who use informal systems as the Hawala-Banking.

IV. MONEY LAUNDERING

Economic development and globalization of international markets have created a favorable atmosphere for the emergence of new forms of crime such as money laundering,

which may contribute to destabilized and damage economic systems. In particular, money laundering has acquired great importance in the last two decades what has caused on the one hand, the establishment and development of preventive measures of money laundering and, on the other hand, a progressive hardening of penal measures.

Money laundering is a phenomenon that was born relatively recently, closely related to drug trafficking. In Spain, as from the appearance of the 1995 Penal Code, money laundering was associated with several serious crime that are to be punished by more than three years of prison, but due to the last reform of the Penal Code, money laundering can be associated with any type of crime.

As money laundering is a transnational problem, the international community has tried to boost the fight against such crime, approving of conventions and treaties, which have been adapted in the internal acts of the European States to take repressive measures and preventive measures. Launderers have taken advantage of this international factor to carry out their activities outside national borders, looking for countries where the prevention is no strict. Thus, one of the methods most used for money laundering are tax havens, where they can easily avoid the hefty taxes that some people, both natural and legal, have in their places of origin. Therefore, in recent years, the tax information exchange among States has acquired dimensions unthinkable a few decades ago, it all in the interest of stability of the global economy.

To summarize, the purpose of money laundering is that the funds obtained through illegal activities appear as the result of legitimate activities and circulate apparently legal in the financial system [24].

V. DIFFERENCES BETWEEN MONEY LAUNDERING AND FINANCING OF TERRORISM. MONEY LAUNDERING REVERSE

From the definitions of money laundering and terrorism financing we can see that the objective of money laundering is giving a legitimate appearance to the money that comes from crimes. Contrary, financing of terrorism use legitimate or illegitimate funds that are used for illegitimate activities. Because of this, terrorism financing has been called "**money laundering in reverse**".

So, should money laundering and financing of terrorism be regulated together? Money laundering and financing of terrorism, despite being totally different procedures, use the same methods to them purposes, therefore, although a priori they may seem diametrically opposed between them, they share a lot of factors in common. The process of financing of terrorism works like money laundering, but in reverse. In other words, it can be seen how terrorist financing shares the modus operandi of money laundering but in the other way [3]. While the money laundering process involves injecting illegally money into the financial system to become legal, in terrorist financing the process is reversed, this is that we have legal or illegal funds that will be used for illegal activities. As a result, in financing of terrorism becomes more important the trail concealment that the money laundering process. [15]

The different is the purpose of money laundering and financing of terrorism, so, this difference of purpose do not always permit that preventive mechanisms to combat money laundering are equally effective in preventing terrorist financing. Anyway, in practice, money laundering and terrorist financing can often appear intermingled, their closeness is irrefutable.

But one problem of this reasoning is that when we have money from illegal sources to finance illegal activities such as terrorism, money laundering is unnecessary and ineffective means to control for these cases. This money will never be introduced in the financial system and its detection is extremely complicated. In these cases, the money is kept in the underground economy and if they need to move this money, these organizations use the informal transfer modes parallel to traditional financial system whose goal is to blur the money trail (the hawala system). So, the money remains in the informal economy and uses informal procedures.

To sum up, although the methods to combat money laundering are not always effective to combat financing of terrorism, notwithstanding, in order to fight against these crimes we think that a cooperation between the authorities and the organism in charge of these crimes will be very effective and they will change information about both directions of financial flows (from legal to illegal and vice versa).

Also, we must keep in mind that terrorist organizations sometimes do not require major infrastructure to carry out their criminal purposes because some attacks are really low cost and the financial resources needed for these groups are not significant enough to arouse suspicions for the control authorities. So, financial controls are not a truly effective method for fighting financing of terrorism. We need other methods to control and prevent this crime because the money that they use for their criminal porpoises is only a mean not the end of the terrorist attack.

After 11S multitude of measures were developed to reduce the financing of terrorism, (i.e. to detect suspicious transactions and proceed to lock them). These types of measures have been mostly preventive and ineffective because the authorities are fighting against an unknown phenomenon with methods that have been created for other crimes, such as money laundering, but not identical. But it is a first step to fight against financing of terrorism [2]

VI. CONCLUSION

Terrorism and money laundering are a challenge to modern societies. Terrorism may produce direct costs (the terrorist attacks) and indirect costs, the reaction of economic agents to the threat of terrorism and to money laundering [14]. We have focused this paper in the indirect costs of these crimes and how the governments fight against this delinquency with preventive and repressive measures. So, we argued that the preventive measures are more effective that repressive measures to fight against these types of crimes.

The governments may create instruments to prosecute the financial funds of these terrorist groups. We must put the start point of these legislations in the 11S. After these terrorist

attacks several measures were introduced to fight against money laundering which were extended to face terrorist financing. However, as we have said in this paper, a simple analogy between money laundering and terrorist financing is a weak comparison. The aim of money laundering is to give appear legitimate to the money. Contrary to this, terrorist groups can be financed by legitimate or illegitimate sources but always the use of these funds will be criminal. For that, some authors say that terrorist financing is "money laundering reverse".

Should be terrorist financing and money laundering be regulated together on preventive measures? The finance of terrorism (and considering the role of money laundering in this process) must be fight since the point of view of preventive legislations, interrupting the flows of money. This preventive policy tries to make terrorism more difficult and expensive and thus less likely. The problem of these preventive methods is that nowadays there are terrorist groups that only need a small budget for their criminal purposes. This movement of funds can be less easily detected by money laundering prosecutors. So, we think that, with the preventive legislation that exist nowadays to prosecute financing of terrorism and money laundering, we need to add new exclusive legislation to fight against financing of terrorism, because this crime have peculiarities that money laundering does not has.

Finally, we think that it is necessary to incorporate a specific offense criminalizing terrorist financing, different from the crime of terrorism but it is desirable that it complies with our tradition, ancient history to suffer the scourge of this extremely serious crime. Maybe, in the future, we could move towards a European criminal law.

REFERENCES

- [1] Barnier, M., 2013. Anti-Money Laundering: Stronger rules to respond to new threats. *European Commission Press Release*. http://europa.eu/rapid/press-release_IP-13-87_en.htm accessed July 10, 2013)
- [2] Campón Domínguez J.A., 2004. El blanqueo de capitales y la financiación del terrorismo como amenazas a la seguridad. *Cuadernos de la Guardia Civil: Revista de seguridad pública*, ISSN 1136-4645, N° 30, pp. 119-144
- [3] Cano Paños, M.A., 2008. Los inicios de la lucha antiterrorista en Alemania. *Revista Electrónica de Ciencia Penal y Criminológica*, p. 1-31 <http://criminol.ugr.es/recpc/10/recpc10-14.pdf> (accessed July 10, 2013)
- [4] Enders, W., Sandler, T. 2002. Patterns of Transnational Terrorism, 1970-1999: Alternative Time-Series Estimates, *International Studies Quarterly*, 46(2), 145-165.
- [5] Ertl, B. 2004. Der Kampf gegen Geldwäscherei und Terrorismusfinanzierung, *Working Paper 4/2004*, Bundesministerium für Finanzen, Vienna. http://www.diw.de/documents/publikationen/73/diw_01.c.404013.de/di_w_econsec0065.pdf (accessed August 6, 2013)
- [6] FATF/OECD (2010a) "FATF 40 recommendations, October 2003, incorporating all subsequent amendments until October 2004", Financial Action Task Force, Paris, www.fatf-gafi.org (accessed August 6, 2013)
- [7] FATF/OECD (2010b) "FATF IX Special recommendations on terrorist financing, October 2001, incorporating all subsequent amendments until February 2008", Financial Action Task Force, Paris, www.fatf-gafi.org (accessed August 6, 2013)
- [8] Giménez-Salinas Framis, A., 2007. La financiación del terrorismo de Al-Qaeda: una lucha desenfadada. *Athena Paper*, Vol. 2, No 22, <http://www.gees.org/documentos/Documen-02655.pdf> (accessed August 5, 2013)
- [9] Haigner, S.D., Schneider, F. and Wakolbinger, F., 2012. Combating money laundering and the financing of terrorism: A survey. *Economics of Security Working Paper 65*, Berlin: *Economics of Security*.

- http://www.diw.de/documents/publikationen/73/diw_01.c.404013.de/diw_econsec0065.pdf(accessed August 5, 2013)
- [10] Hardouin P., Weichhardt, R. 2006. Terrorist fund raising through criminal activities, *Journal of Money Laundering Control*, 9(3), 303-308.
<http://www.emeraldinsight.com/journals.htm?articleid=1563503&show=abstract> (accessed August 5, 2013)
- [11] Hinojosa Martínez, Luis M., 2009. *La financiación del terrorismo y las Naciones Unidas*. Madrid. Tecnos.
- [12] Johnson, J. 2001. In Pursuit of Dirty Money: Identifying Weaknesses in the Global Financial System, *Journal of Money Laundering Control*, 5(2), 122-133.
- [13] Johnson, J. 2008. Is the global financial system AML/CFT prepared?. *Journal of Financial Crime*, 15(1), 7-21.
<http://www.emeraldinsight.com/journals.htm?articleid=1641902&show=abstract> (accessed August 7, 2013)
- [14] Krieger, T. and Meierrieks, D., 2011. Terrorist Financing and Money Laundering. *Working papers series*. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1860069(accessed August 5, 2013)
- [15] Koh, J.-M., 2006. *Suppressing terrorist financing and money laundering*, Springer, Berlin.
- [16] Laufhütte, Heinrich Wilhelm / Rissing-van Saan, Ruth / Tiedemann, Klaus (Hrsg.), 2009. *Leipziger Kommentar zum StGB*, Band 5, 12. Aufl. Berlin.
- [17] Levi, M., Gilmore, W. 2002. Terrorist Finance, Money Laundering and the Rise and Rise of Mutual Evaluation: A New Paradigm for Crime Control. *Financing Terrorism*, Netherlands, Kluwer Academic Publishers, 87-115.
- [18] Palicio Díaz-Faes, I., 2010. El intercambio internacional de información financiera y la lucha contra la financiación del terrorismo: el acuerdo UE-EEUU sobre Swift. *Análisis del Real Instituto Elcano* (ARI), ISSN-e 1696-3466, N°. 49, pp. 1-7 http://www.realinstitutoelcano.org/wps/wcm/connect/67ec378041c58174a6dcb6a33d11d698/ARI49-2010_Palicio_intercambio_informacion_financiera_terrorismo_Swift.pdf?MOD=AJPERES&CACHEID=67ec378041c58174a6dcb6a33d11d698 (accessed August 6, 2013)
- [19] Passas, N., Giménez-Salinas Framis, A., 2007. La financiación del terrorismo de Al-Qaeda: mitos y realidades. *Inteligencia y seguridad: Revista de análisis y prospectiva*, 2, junio-noviembre, pp-493-521.
http://e.spacio.uned.es/fez/eserv.php?pid=bibliuned:DerechoPenalCriminologia2007-15&dsID=financiacion_terrorismo.pdf (accessed August 5, 2013)
- [20] Passas, N., 2004. Law Enforcement Challenges in Hawala-related Investigations. *Journal of Financial Crime* 12(2).
<http://www.emeraldinsight.com/journals.htm?articleid=1533889&show=html> (accessed August 7, 2013)
- [21] Schneider, F. and R. Caruso 2011. The (Hidden) Financial Flows of Terrorist and Transnational Crime Organizations: A Literature Review and Some Preliminary Empirical Results. *Economics of Security Working Paper* 52, Berlin: Economics of Security. http://www.diw.de/documents/publikationen/73/diw_01.c.386645.de/diw_econsec0052.pdf (accessed August 7, 2013)
- [22] Schneider, F. 2009. Die Finanzströme von Organisierter Kriminalität und Terrorismus: Was wissen wir (nicht)!. *Vierteljahreshefte zur Wirtschaftsforschung*, DIW Berlin, 78(4), 73-87.
- [23] Schneider, F., Dreer, E., Riegler, W. 2006. *Geldwäsche: Formen, Akteure, Größenordnung – Warum die Politik machtlos ist*. Gabler-Verlag, Wiesbaden.
- [24] Schneider, F., Windischbauer, U., 2008. Money Laundering: Some Facts, *European Journal of Law and Economics*, 26(4), 387-404.
http://econpapers.repec.org/article/kapejlwec/v_3a26_3ay_3a2008_3ai_3a3_3ap_3a387-404.htm (accessed August 7, 2013)

C. Mallada Fernández is PhD in Law with summa cum laude (University of Oviedo, 2012). She has been a postdoctoral researcher in the Humboldt University in Berlin and now she is Prof. Dr. Assistant in the University UDIMA of Madrid (Spain) Her research is focused in money laundering, financing of terrorism and taxation.